

Introduction to the IT Aspects of Mergers, Acquisitions, and Divestitures

Varun Joshi
Saurav Sharma

While many mergers and acquisitions (M&A) transactions fail to deliver value, a lesser-known but by some measures a more important fact is that the axis of value in mergers, acquisitions, and divestitures is more directly linked to getting information technology (IT) right than anything else. Information technology is generally the single biggest cost element in an M&A event (see Exhibit 1.1)—and can be the single biggest enabler of synergies. Getting IT involved early and often throughout the M&A lifecycle can be critical for effective execution and realization of benefits from a merger, acquisition, or divestiture.

Today, more than ever, the role of IT is under the lens as significant simultaneous disruptive forces are altering the technology landscape, and expectations are higher than ever from IT to enable changing business demand patterns. Disruptive technologies such as cloud computing, social media, mobility, and big data require a fundamental shift in the delivery and consumption of IT services. Business users now expect cheaper and more rapid deployment of technology to support business objectives through cloud computing and everything as a service (XaaS) platforms. Social technologies are enabling opportunities for collaboration, communication through social networks—the connected web of people and assets—and providing vehicles for discovering, growing, and propagating ideas and expertise. Mobility trends such as bring your own device (BYOD) are redefining mobile device management and enterprise security and privacy policies and procedures. Finally, through the application of big data, enterprises are looking to harness unstructured data formats that are not easily analyzed through existing business intelligence/analytics tool implementations.

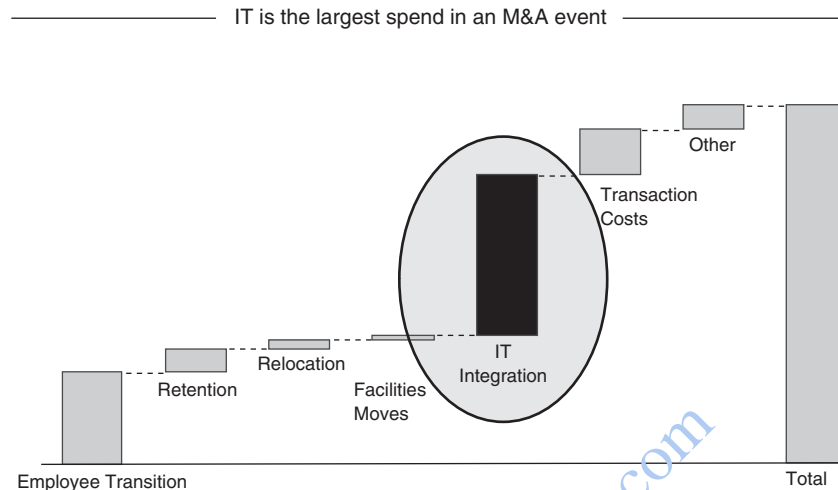


EXHIBIT 1.1 M&A Spend Distribution

Source: Deloitte Analysis

These disruptive trends provide IT organizations with new tools to add to their arsenals, and through their appropriate utilization IT organizations can increase the likelihood of achieving three critical goals of an M&A transaction:

1. Execute an issue-free Day 1.
2. Enable the realization of synergy targets.
3. Establish future-state platforms to support business growth.

ROLE OF IT IN M&A

While the drivers for M&A can be varied, at the most fundamental level an M&A transaction is largely about realization of business benefits through synergy capture—whether cost savings or growth/strategy enablement (or both). The heavy reliance on information technology (IT) for business operations, management information, and financial reporting in today's business environment makes IT a priority item in the M&A agenda. An M&A transaction can add a significant degree of complexity to preexisting and often complex IT environments. Integrating or carving out complex systems requires a very strong focus on IT. However, companies often neglect or give low priority to IT during the early stages of the M&A

lifecycle. The lack of focused IT involvement early on can have serious consequences, including:

- **Unexpected integration/divestiture costs.** IT-related activities are generally the largest cost items in a merger or divestiture. However, because IT is a secondary focus in most deals, the magnitude, complexity, and cost of these activities are often significantly underestimated.
- **Long delays in capturing benefits.** Many M&A deals expect significant synergies from economies of scale, cross-selling, consolidation of business back-office operations, and legacy system retirement. All of these synergies have one thing in common—they require major IT changes. Yet many companies put off developing an IT integration strategy and detailed IT plans until the deal is essentially closed. This delayed IT involvement can put IT in a reactive mode and make it virtually impossible for companies to achieve their aggressive goals.
- **Temporary IT solutions that are expensive, risky, and wasteful.** Because of the long lead times associated with IT, many companies are forced to develop and implement transition services agreements (TSAs) in order to close deals on schedule. While in some circumstances TSAs will be unavoidable, these short-term solutions for IT systems and business processes can be difficult and expensive to set up and can also increase security risks. To the extent IT has visibility early in the cycle, appropriate alternatives can be planned and developed so that TSAs are less comprehensive and complex in nature.

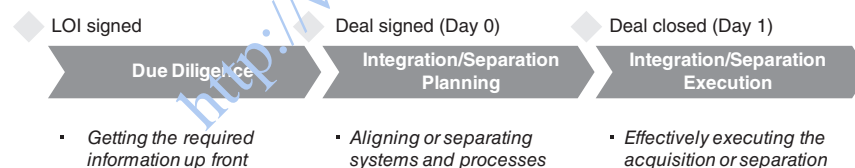


EXHIBIT 1.2 M&A Lifecycle

In order to effectively partner with business stakeholders to achieve the desired goals of an M&A transaction, CIOs and IT executives must understand the M&A lifecycle (see Exhibit 1.2), the different types of M&A transactions, their impact on the IT function, and the contributions required from the IT organization.

Key milestones in the M&A lifecycle include:

- **LOI (letter of intent) signed.** Period of exclusivity; due diligence initiated.

- **Deal signed/announced (Day 0).** Period to obtain regulatory and shareholder approvals; integration/separation planning initiated.
- **Deal closed (Day 1).** Financial close of the transaction; integration/separation execution.

DUE DILIGENCE

No matter what the M&A agenda may be, due diligence is not an optional process. When done effectively, due diligence can help identify risks and opportunities. The risks include sources of instability requiring immediate action. Opportunities to reduce costs, to leverage resources or assets in new areas, and to improve IT effectiveness and increase business flexibility can be identified and pursued. During the due diligence process, decisions or actions that will be needed before there is any significant progress on the merger or separation can be identified. Expectations can also be set. For example, order-of-magnitude estimates of expected costs and anticipated benefits can be developed, and resources and timeframes required to address risks and issues and to capitalize on opportunities can be identified.

In our experience, the majority of transactions fail to achieve the required level of synergy due to inadequate focus on IT due diligence up front in the transaction cycle. Including IT in preannouncement due diligence and preparation can help with the early identification of potential synergies from the M&A transaction, empower business executives to take advantage of the important role IT plays in realizing M&A synergies, and support the collaboration of business leadership and IT in determining an effective integration or separation strategy. (See Chapter 5 for a more complete discussion of due diligence.)

Key Considerations for IT Due Diligence

One of the key objectives of IT due diligence is to review IT assets, processes/operations, and organization to build a quantitative and qualitative picture of the merged or separated entity. The due diligence process includes questioning of knowledgeable personnel, competitive benchmark analysis, and an evaluation of IT documentation across the people, process, applications, and infrastructure domains (see Exhibit 1.3). This involves looking at the key attributes in each of the domains and identifying areas in which IT is a significant or critical element of the business plan. It enables companies to evaluate the effectiveness of IT systems and IT strategy, and identify factors that could be a barrier to achieving expected results.

EXHIBIT 1.3 Dimensions of IT Due Diligence

People, Process, and Spending	Applications	Infrastructure
<ul style="list-style-type: none"> ■ IT organization ■ IT strategic planning and projects ■ IT operating and capital expenditure ■ User support (help desk, desk support) ■ Security and disaster recovery 	<ul style="list-style-type: none"> ■ Enterprise (ERP, financial reporting, consolidation, human resources, etc.) ■ Specialized (revenue-generating portals, supply chain, manufacturing execution systems, distribution and logistics, safety, risk and compliance, etc.) 	<ul style="list-style-type: none"> ■ Hardware (mainframes, servers, PCs, peripherals) ■ Operating systems and databases ■ Network ■ Communication and interfaces to third-party providers (distributors, etc.)

From our experience, the application of the following IT due diligence best practices can significantly improve the odds of achieving expected M&A transaction benefits:

- **Assign senior IT executives to help with IT due diligence.** Make the seniormost member (CIO or designee) the key member in the IT due diligence team and involve the IT function in all phases of the M&A lifecycle, from preliminary due diligence to Day 1 and beyond until all key synergies have been captured.
- **Team IT with business.** For smooth functioning of M&A deals and to operate the program effectively, staff people from IT and from business areas to jointly drive planning and execution. This encourages collaboration and teamwork between IT and the business/functional areas, which is an effective strategy to foster a strong working relationship and sense of ownership.
- **Identify IT requirements before you sign the deal.** Insist the team identify IT investments that will be needed to achieve the expected short- and long-term benefits. Technology-related synergies often occur over multiple years. Also, it is essential to develop order-of-magnitude estimates for these critical IT projects to validate the magnitude and timing of the expected benefits.
- **Make IT costs and timing part of deal valuation.** Make IT investments a mandatory part of your valuation model, and include estimated costs for IT projects that are required for capturing the expected short- and long-term business synergies, as well as costs for software licensing and TSAs.
- **Get a head start on IT projects.** “Clean teams” are groups of specialists who are given special access to restricted information before the deal is

complete. They can provide an early start on time-critical IT activities. For example, clean teams can be used to compare business and data models, assess the impact of the deal on the company's future IT landscape, and conduct detailed scoping and planning.

- **Get your priorities straight.** Every deal has an impact on IT, and it is essential to immediately inventory and assess IT projects (even those not directly related to the deal) to verify that they are still required and align with the company's future direction. Priority should be given to IT projects that (1) link to critical Day 1 requirements, (2) enable or accelerate large synergy opportunities, or (3) are essential to implementing the company's future strategic initiatives.
- **Keep the pressure on.** An effective Day 1 is only the beginning. IT projects that are critical to synergy capture and to long-term deal results often require many months to complete. To maintain critical momentum for an integration or divestiture, it is vital that management stays focused on related projects until the majority of benefits have been captured.

A well-executed IT due diligence effort should result in a baseline understanding of anticipated costs as well as a high-level action plan to mitigate identified risks, resolve specific identified issues, and capitalize on major opportunities.

INTEGRATION/SEPARATION PLANNING

The old adage "Those who fail to plan, plan to fail" is particularly applicable to M&A transactions. IT integrations or separations are typically complex, resource-intensive initiatives that should be closely aligned with the overall business integration or separation effort. This type of activity requires significant time and staff and must be done in addition to the day-to-day activities of the IT function required to keep the business running effectively. As a result, the normal IT activity combined with effectively executing M&A transaction-related tasks can put significant levels of stress on an IT function. Exhibit 1.4 shows the specific focus areas that should be considered during the planning phase.

Selection of the appropriate integration or separation model is a critical aspect of planning the IT effort to support an M&A transaction. The model chosen is dependent on the goals of the new entity and is based on the M&A objective driving the deal.

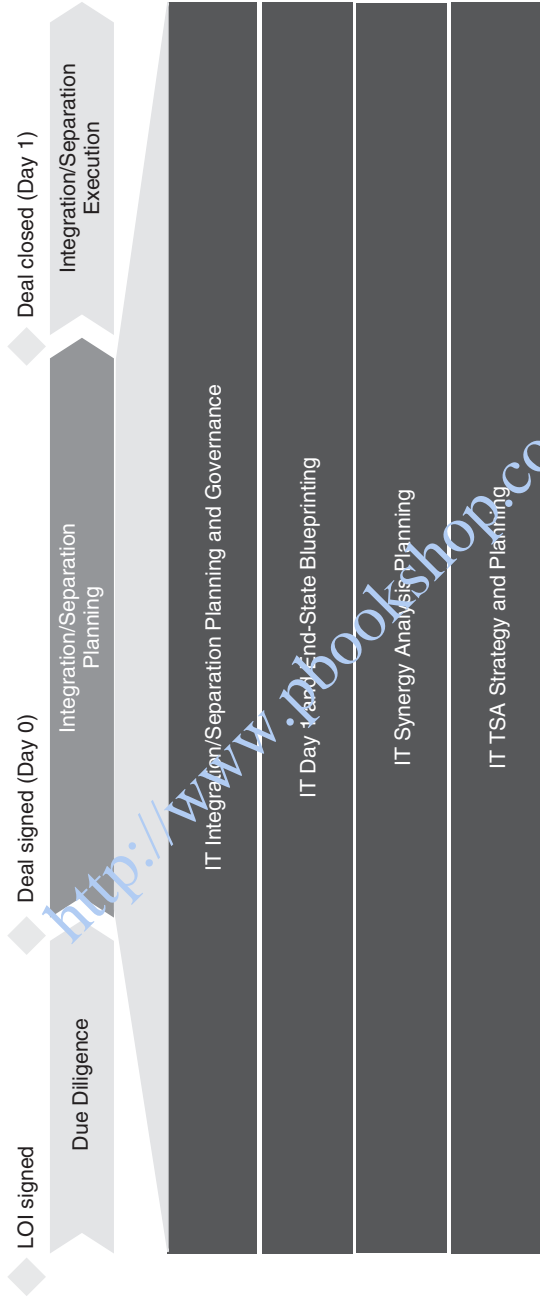


EXHIBIT 1.4 Integration/Separation Planning

Integration Models In general, there are four models that can be applied to post-merger integration of most M&A transactions (see Exhibit 1.5).

See Chapters 8 and 9 for detailed discussion of these four models.

Separation Models Typically there are six models that can be applied to IT systems separation or carve-outs, as shown in Exhibit 1.6.

IT Day 1 and End-State Blueprinting

Blueprinting helps address the organizational, functional, and technical requirements for Day 1 and the end state. These requirements will drive projects, milestones, and timetables (for example, Day 1, Day 1 + 30, Day 1 + 90). A structured integration blueprinting approach can enable IT and the business to rapidly identify cross-functional requirements at the operational level. Blueprinting should start with the end in mind and work backward to Day 1. The two key phases in the blueprinting phase include:

- **End state.** What does IT look like today, and what will it look like when the integration or divestiture is complete? How long will it take to reach the end state (organization, infrastructure, applications, service delivery model)? What value will be captured as a result of the integration or divestiture?
- **Day 1.** What is absolutely essential for meeting Day 1? These requirements should be highly focused on keeping the business running, removing uncertainty for stakeholders, complying with regulatory requirements, and delivering the Day 1 must-haves. Some typical examples of Day 1 requirements include:
 - Keep the business running. The company must be able to take orders, invoice the customers, and deliver product.
 - Comply with federal, legal, and regulatory requirements. On Day 1, licenses must be transferred, applied for, or in place, and contracts must be assigned. Finance has to be able to produce consolidated financial reports.
 - Deliver Day 1 must-haves. IT has to establish e-mail connectivity, voice mail, and some level of file transfer capability.

Exhibit 1.7 is an example of a blueprint of IT strategies for Day 1 and the end state.

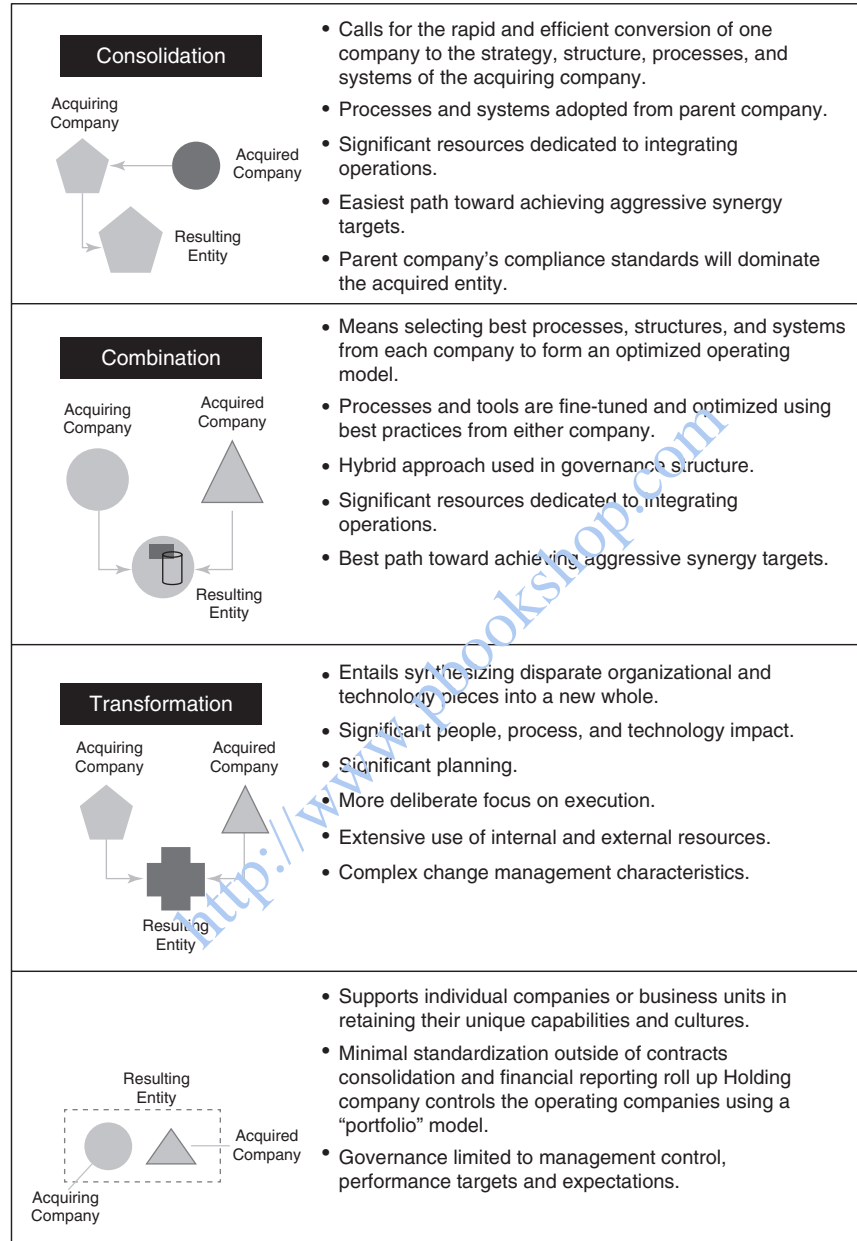
**EXHIBIT 1.5** Integration Models

EXHIBIT 1.6 Separation Models

Model	Advantages	Disadvantages
Clone and go ■ Set up a copy of production/application on a separate instance; operational Day 1	■ Time-efficient solution; incorporates flexibility needed for moving divestiture	■ Sensitive data might be exposed to the buyer
Clone, vitiate, and go ■ Clone copy, clean out sensitive data (legal and competitive), release for production use	■ Competitively sensitive data is masked from the buyer; incorporates flexibility, is operational Day 1	■ Requires more time than clone and go
Copy, configure, and load ■ Create a configuration-only copy of application, then load relevant master and transactional data onto new/separate instance	■ Outcome is predictable; know-how for doing this is widely available	■ Longest timeline, scope needs to be static; more expensive
Extract and go ■ Extract data from production systems, put in flat file, and hand over to buyer	■ Quick and easy for seller; low-cost option	■ Potentially nonviable option for the buyer (may not have an operational business on Day 1); significant pressure on buyer to keep the business operational during the transition
Give and go ■ Hand off production system to buyer	■ Buyer is operational Day 1 with a system that is familiar; users are comfortable; seller costs drop immediately	■ Deal will involve personnel; seller will no longer have access to historical data; potentially sensitive data will be left in the system
Hybrid ■ Choose different techniques for different application suites	■ Overall risk may be better managed; more options to effectively get to Day 1	■ Requires detailed planning early on for each suite; business participation is increased

EXHIBIT 1.7 IT Blueprint Sample

Subfunction	Process/Subprocess Strategy		Application	Technology (Application)	
	Day 1 Strategy	Day 1 to Day 2 Exit Strategy		Day 1 Strategy	Day 1 to Day 2 Exit Strategy
Example: HR— Organization Design and Structure	<ul style="list-style-type: none"> ■ Performed manually by buyer 	<ul style="list-style-type: none"> ■ N/A 	<ul style="list-style-type: none"> ■ Human resource information system (HRIS) 	<ul style="list-style-type: none"> ■ Transferred to buyer on Day 1 	<ul style="list-style-type: none"> ■ N/A
Example: Finance— Fixed Assets	<ul style="list-style-type: none"> ■ Continue to use same processes and systems ■ Identify assets migrating to buyer and book value 	<ul style="list-style-type: none"> ■ Migrate to buyer systems and processes ■ Train fixed assets resources 	<ul style="list-style-type: none"> ■ Asset manager 	<ul style="list-style-type: none"> ■ Transition services agreement (TSA) 	<ul style="list-style-type: none"> ■ Develop data separation plan from seller system ■ Migrate information to buyer system

IT Synergy Analysis Planning

In most M&A events, companies expect synergy—a business value that comes from the fact that the two entities are (or should be) more valuable together than apart. Synergy comes from various sources, such as reduced operating costs, reduced risks, increased market share, or the ability to enter or create a new market. Synergies are captured by sharing overhead functions, integrating operations, jointly creating new capabilities, and exploiting economies of scale. The objective of synergy analysis planning is to lay the foundation for accelerating benefits realization from the integration. (See Chapter 7 for a more in-depth discussion of synergies.)

Develop IT Cost
Baseline

Conduct Top-down
Target Setting

Develop Bottom-up
Synergy Commitments

Create Tracking Tools
and Processes

EXHIBIT 1.8 Key Phases in IT Synergy Capture Analysis

Exhibit 1.8 shows the following key steps involved in performing IT synergy capture analysis:

- **Develop IT cost baseline.** The first step in synergy analysis planning is developing an IT cost baseline by reviewing various cost sources as well as the due diligence analysis to develop a common view for cost. Cost baselines are developed at the regional and functional level. This step also involves identifying best practice synergy opportunities, using benchmarks to compare the baseline.

- **Conduct top-down target setting.** This step involves identifying high-level synergy initiatives and communicating a range of savings at the functional/regional level. High-level synergy initiatives are identified by function, and potential savings are estimated using best practice benchmarks. The identified synergy targets are reviewed with management to communicate synergy ranges to functional/regional teams.
- **Develop bottom-up synergy commitments.** This step involves taking the high-level synergy targets and developing detailed initiatives that match or exceed targets. Validate IT cost baselines alignment. Detailed project plans are developed and reviewed with management.
- **Create tracking tools and processes.** Processes and tools necessary to track and prioritize synergy initiatives on an ongoing basis are developed. A central repository should be developed for managing all IT projects across regions/functions along with the high-level process for tracking synergies.

IT TSA Strategy and Planning

Identifying and carving out the pieces in a divestiture can be a complex and time-consuming process, particularly when the affected people, processes, and systems are deeply integrated within the seller's business, or when services and infrastructure are shared across multiple business units. During the planning process, participants from the affected business units on both sides must think through the transition period from Day 1 (financial close) to Day 2 (full separation/exit) to determine the strategy for each business process, associated applications, and underlying infrastructure. Depending on the strategy, it may be beneficial for certain services to be covered under a transition services agreement (TSA). A TSA is a legal agreement, separate from the separation and purchase agreement, in which the buyer agrees to pay the seller for certain services to support the divested business for a defined period of time. TSAs are most often used in carve-outs where the buyer lacks the necessary information technology capabilities or capacity to support the business on its own. For instance, many private equity (PE) firms rely on TSAs until they can identify and engage an IT outsourcing vendor. TSAs are also often necessary when the deal closes faster than the buyer's organization can respond. (See Chapters 14 and 16 for detailed discussion of TSAs.)

Exhibit 1.9 shows an illustrative timeline for establishing TSAs and the key activities involved.

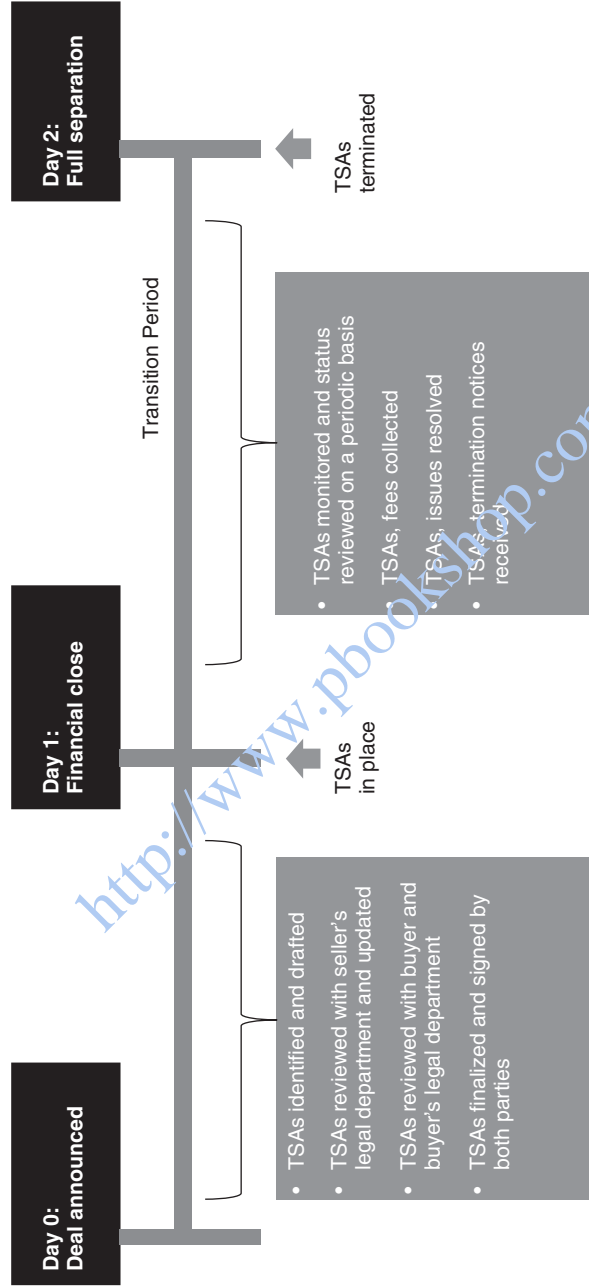


EXHIBIT 1.9 TSA Timelines
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INTEGRATION/SEPARATION EXECUTION

Execution priorities focus on process and technology integration or separation in order to realize synergy benefits driving the M&A transaction. The emphasis is on effectively and efficiently reaching the end state (organization, infrastructure, applications, service delivery model) while capturing synergy targets. Typically, experience breeds effectiveness, and companies that have participated in multiple M&A transactions often fare better than companies that are undergoing the process for the first time. The execution of the IT integration or separation process is where third-party advice and assistance can often be extremely valuable, especially to companies that are attempting post-merger IT integration or divestiture IT carve-out for the first time, or that lack a series of deals to draw upon. Exhibit 1.10 shows the specific focus areas that should be considered during the execution phase.

IT Integration/Separation Program Management

A detailed, developed, and defined program structure and decision-making mechanism are critical to control all aspects of the execution. An IT program management office (PMO) should be established to manage overall integration or carve out activities and provide overall day-to-day direction. The PMO should also drive detailed IT blueprint and work plan development and execution, and provide common tools and templates for all IT working teams to capture functional plans and synergies through center of excellence (COE) and playbooks. Exhibit 1.11 shows an illustrative governance structure to drive IT integration or separation program management.

IT Blueprint Design Execution

The execution phase is where the rubber meets the road. Execution of M&A transactions can be extremely complex due to the fluidity of the decision making, the need for speed, and the change aspects imposed on the organization due to the M&A event. Having a well-defined program structure and framework for execution is critical for removing uncertainty from some of the controllable elements.

Integration will typically translate into decisions to retire, replace, consolidate, or upgrade applications and associated platforms. Exhibit 1.12 highlights a framework that can be adopted to execute IT integration.

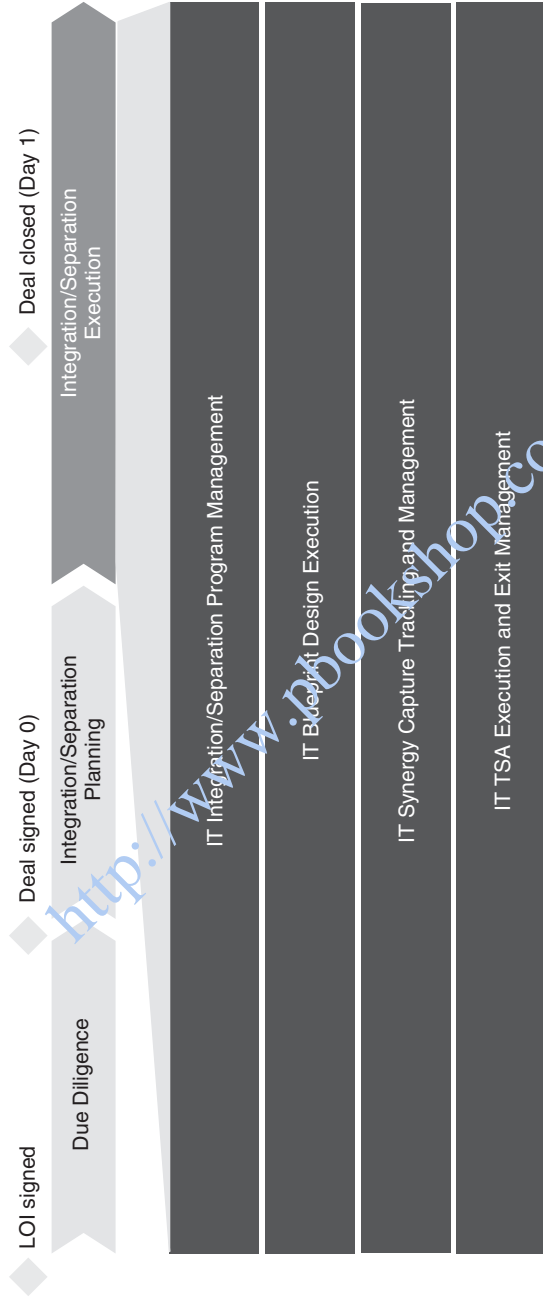


EXHIBIT 1.10 Integration/Separation Execution

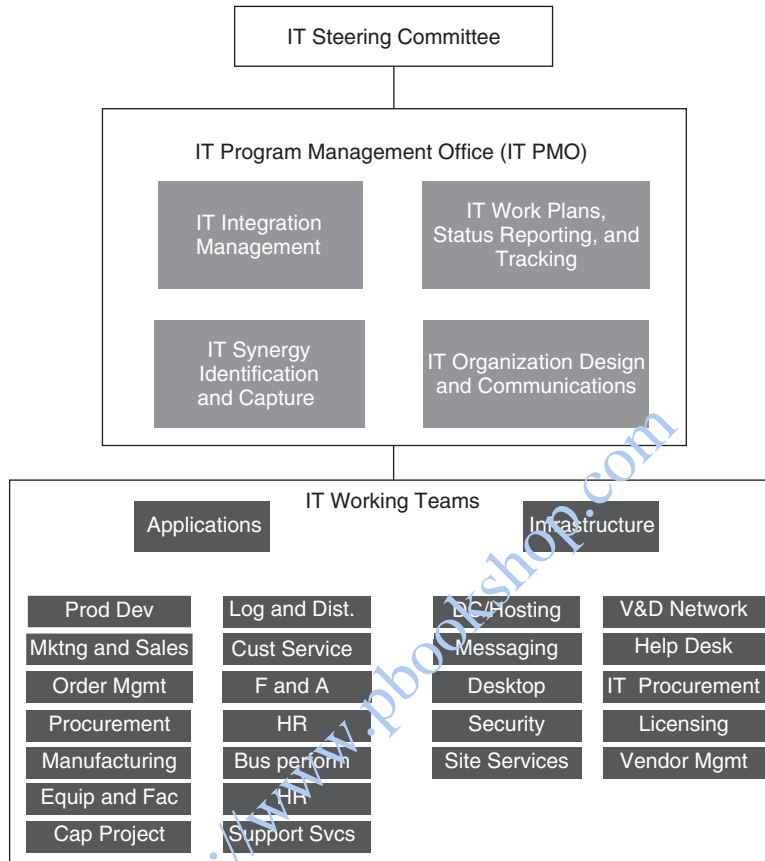


EXHIBIT 1.11 IT Governance Structure

An objective during the execution phase is to tie the IT initiatives to the synergy targets so they will enable and have a full cross-functional view of the risks and dependencies across the organization.

IT Synergy Capture Tracking and Management

An objective of synergy capture tracking is to establish a formal mechanism for tracking the capture of synergy targets. The two specific focus areas in this process are:

1. **Establish tracking organization.** The IT PMO should set up an IT synergy tracking function to achieve stated synergy targets and prioritize

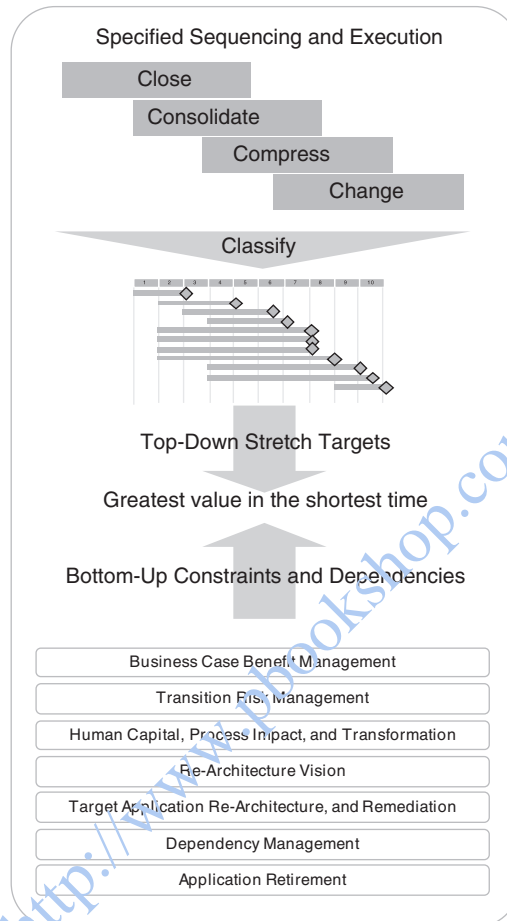


EXHIBIT 1.12 IT Application Integration Framework

as necessary. This function will work closely with the finance department to capture financial data from IT projects and help ensure that financial metrics and targets are being met.

2. **Track synergies.** The IT synergy function is responsible for providing executive management an ongoing view of achieved milestones and targets. This involves developing executive dashboards to highlight initiatives by region, function, and total. These dashboards also track critical milestones and achievements and enable reporting of synergy achievement status.

IT TSA Execution and Exit Management

Once the deal closes and the TSAs go into effect, it is important to continually track and manage the services that are being performed. It is also critical to keep track of the migration activities and related step-down in services. The relationship between buyer and seller will inevitably change once the deal has closed, regardless of how well they might have worked together leading up to Day 1. Sellers will focus on cleaning up the bits and pieces the divestiture left behind, and then quickly shift their attention to their retained businesses and other priorities. Buyers may find themselves wrestling with unanticipated service costs and struggling to capture the anticipated and expected integration synergies as quickly as possible.

A well-defined TSA management structure (see Exhibit 1.13) is a critical component for jointly managing service levels after Day 1. Companies should identify and assign a service coordinator to manage their part of the overall relationship. This profile is similar to the vendor manager profile that currently exists in many organizations. They do not need to delve deeply into the details of day-to-day operations; rather, they need a holistic view of the services being provided and an understanding of the overall requirements. Their job is to monitor the services being delivered against the TSA and to keep the separation activities on track. Retention of key transition resources is another important issue. Sellers will generally want to get on with their business by shifting people to new assignments as quickly as possible. To maintain adequate staffing and performance during the transition, buyers must specify in the TSA exactly which key resources and groups will be retained to execute the contracted or required services.

WRAPPING IT UP

In order to effectively partner with business stakeholders, CIOs and IT executives must understand the M&A lifecycle and the contributions required from the IT organization. IT integrations or separations are generally complex, resource-intensive initiatives that need to be closely aligned with the overall business integration effort. A detailed and defined program management structure and decision-making mechanism are critical to control all aspects of the execution. The IT PMO should drive detailed IT blueprint and work plan development and execution, and provide common tools and templates for all IT working teams. Given the high fluidity and speed involved in a transaction, a well-orchestrated PMO provides the much-needed structure to ensure that cross-work-stream dependencies and risks

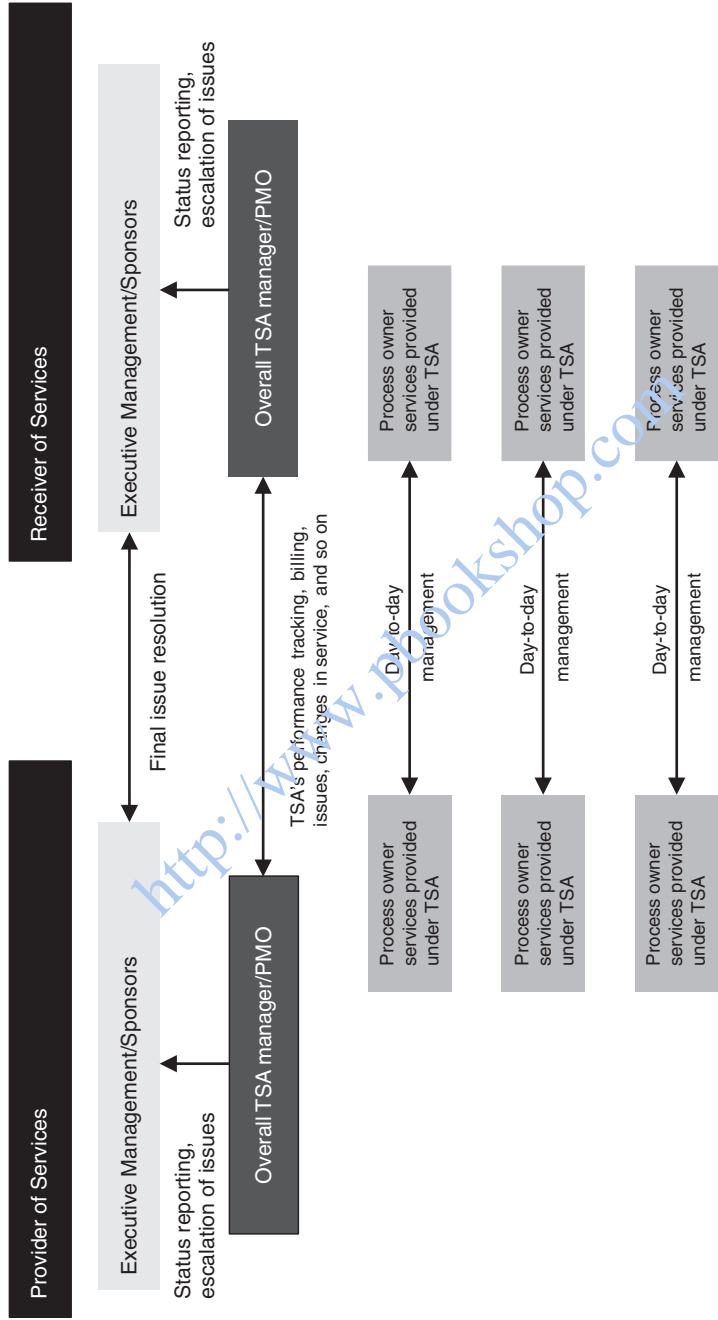


EXHIBIT 1.13 TSA Management Structure

are identified, escalated, and resolved in an expeditious manner. Based on the M&A objective, selection of the appropriate integration or separation model is a critical aspect of planning and executing the IT effort to support an M&A transaction.

Merger, acquisition, and divestiture transactions are not easy. They are fraught with pitfalls and roadblocks to achieving the expected benefits. CIOs have the license to get involved up front in the M&A lifecycle and have the obligation to educate other C-suite executives on the importance of giving IT a head start. Having IT involved up front in the deal is absolutely critical to helping ensure the overall success of the transaction. It enables the IT function to better plan and budget for the costs to achieve. Regardless of the size and complexity of an integration or a divestiture, the IT team's speed and effectiveness are likely to have a major impact on whether the deal ultimately achieves the expected results.

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