WHITE PAPER

Mergers and acquisitions: success starts with transparency

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A best-practice approach to IT integration

Executive summary

Merger and acquisition (M&A) activity is rapidly on the rise. The value of global M&A deals was predicted to increase from $3.66 trillion in 2017 to $4.4 trillion in 2018.[1] At the same time, failure rates for M&A deals are alarmingly high—according to an article in the Harvard Business Review, 70-90% of M&A deals are "abysmal failures.[2]"

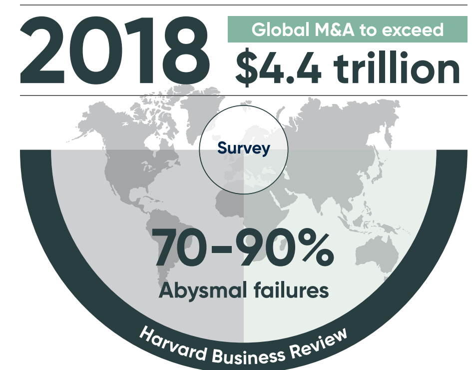
Why is there such a gap between what we expect from M&As and what we actually get? Many executives pin the root cause of M&A failure on IT integration. Industry experts concur in countless articles, white papers, and conferences. Yet, despite this widespread agreement, the high failure rate persists.

It's time for a new strategy. We need an approach that focuses not on integration, but its intended result: transparency.

Transparency—before, during, and after integration—empowers IT to do more than simply integrate the buyer and the acquired company. It enables IT to deliver benefits at all phases of the M&A process—from arriving at accurate valuations in the due diligence phase, to highlighting compliance issues in the planning phase, to understanding exactly what assets are owned and how to optimize their use in the integration phase.

This information is crucial when management is making critical decisions.

Greater transparency can accelerate M&A timelines, impact asset valuations, and influence decision-making about whether and when to integrate acquired organizations. Whether your company is looking for higher value from M&A or higher valuations from divestiture, it's essential to put a premium on transparency—not only when examining your acquisition target's processes, but your own. This white paper will examine how to do that, and provide real-world examples to help you explore possibilities.



The transparency gap: causes and consequences

Why do companies merge? For the same reason they do everything else—to maximize business value.

Traditionally, M&A has done this by helping companies achieve growth targets, minimize risk through diversification, expand their geographical presence, extract costs from operations, and so on. Now, M&A activity also aims to add new technological capabilities, alter the competitive landscape, or change the market in favour of the new entity.

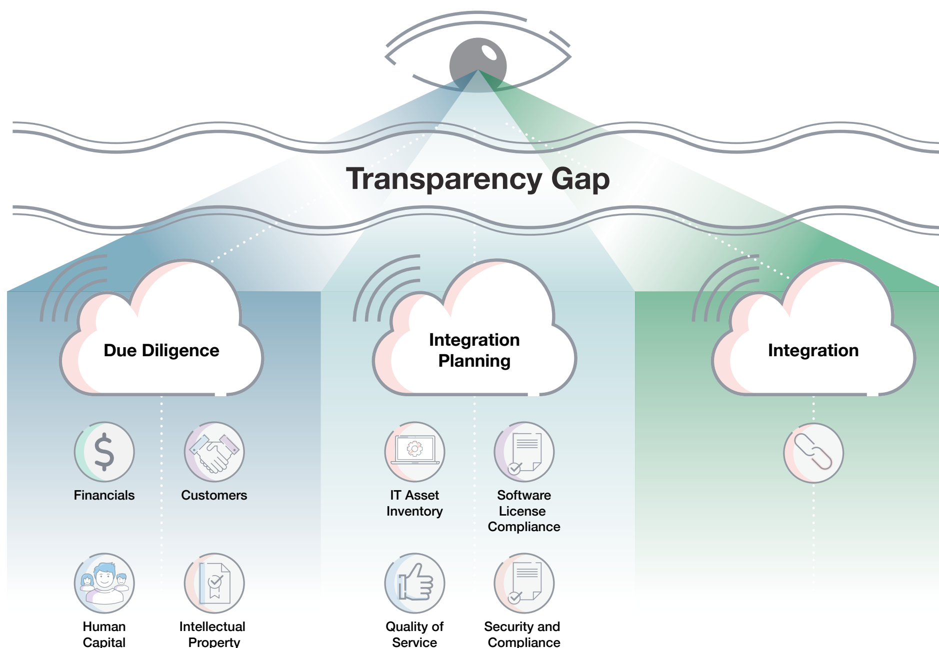
1 Statista 2018
2 Harvard Business Review, "M&A: The One Thing You Need to Get Right," by Roger Martin, 2018.

In Deloitte's 2018 M&A trends report[3], corporate respondents reported diverse motivations for pursuing deals. The most cited reasons included:

- Looking to acquire new technology (19%)
- Looking to build out a digital strategy (16%)
- Seeking major, transformational deals (17%)
- Seeking smaller, strategic opportunities (15%)

Similarly, divestiture aims to increase business value by maximizing the valuation of sold assets and minimizing the costs and disruptions of separation. Your organization's goal is to surpass book value, regardless of whether the divestiture takes the form of a straight asset sale or a joint venture.

No matter what the specific motive behind an M&A transaction is, you can't maximize shareholder value and asset valuations without adequate information about the underlying assets. And yet, there's a difference between the information M&A teams need and the information they actually have available. Let's take a closer look at the hidden causes and costs of this "transparency gap" across the three phases of a typical M&A transaction.



> Divestitures become a lot easier when you have a good service management philosophy. Get your arms around what you have and how it's used. It's not sexy, but you need to do it. There is no point in recreating something that is not used or decommissioned.
>
> – Richard Donaldson, Director of Infrastructure Management and Operations, eBay

[3] Deloitte, "The state of the deal: M&A trends 2018," 2018.

1. Due diligence phase

Financials

As an acquiring company, you want a financial history of the acquisition target, along with current budgets and planned CapEx. You also want to know the purchasing and capitalization process from an IT perspective, where revenue comes from, profitability against cost of sale, the target's ability to meet return-on-sales goals, and so on.

Most legacy systems don't provide insight into where and why budget is allocated and spent, making it difficult to know any of these requirements. As a result, it's likely you'd receive inaccurate assessments of everything from asset values to future revenue streams.

Customers

To arrive at an accurate valuation, an acquiring company needs a complete understanding of the target's entire business—how much it spends, what products it buys, what contracts it has, its terms and conditions, its risks and liabilities, and so on. Unfortunately, customer data is probably dispersed across the enterprise in multiple systems, none of which share data or integrate easily. This makes it nearly impossible to get complete and accurate customer information, which is essential to financial forecasting.

Human capital

Acquiring companies need to know what their target's organization chart looks like and what skills employees possess, which includes everything from job roles to NDAs. However, most legacy systems don't provide centralized access to this data. In addition to making it difficult to adequately evaluate HR issues, lack of transparency contributes to lower-than-expected employee retention rates.

Retaining experienced employees is critical. According to Mercer[4], employee retention is the foremost perceived people risk for global deal makers. Creating a positive onboarding experience for acquired employees can determine the success of an M&A transaction.

Intellectual property and goodwill on the balance sheet

Patents, trademarks, copyrights, and partner agreements substantially impact M&A valuations. Despite this, the vast majority of enterprises struggle with IP tracking, and poor integration across the acquired company can make finding accurate information a time-consuming, expensive, and often fruitless effort.

This can make an organization easy prey for vigilant competitors looking to capture valuable IP at a low price.

M&A: Time is of the essence, but information is limited.

- How do you know what to buy and at what price when you can't get accurate information about the assets?
- How do you calculate the costs of acquisitions when you have little visibility into key processes?
- In divestiture situations, how do you exceed book value without hard data that supports higher valuations?

[4] Mercer, "Flight Risks in M&A: The Art and Science of Retaining Talent," 2018

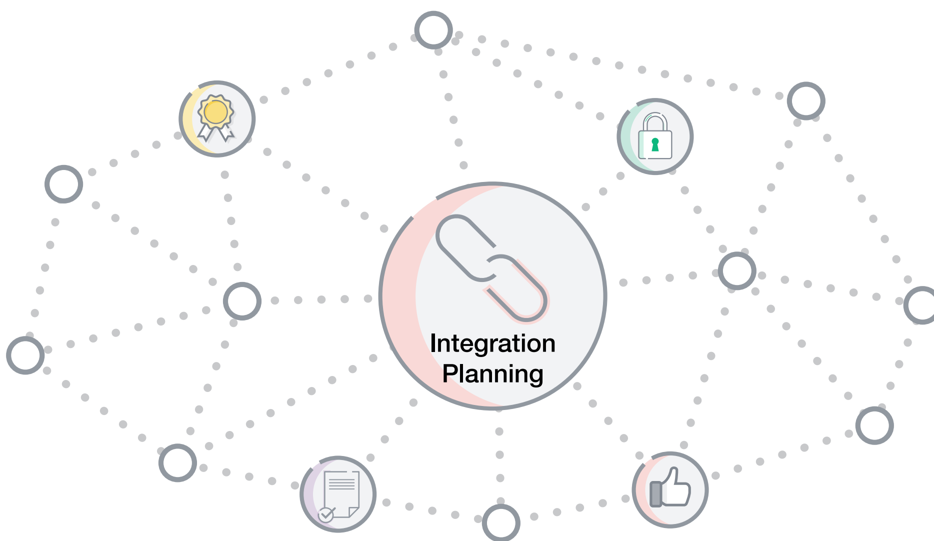
2. Integration planning phase

IT asset inventory

When you enter the planning phase, you need to know what resources are at your disposal. An acquiring company will need a complete and itemized list of which IT assets are owned by the acquisition target and how they're used, as well as which assets may need to be replaced following the acquisition.

Additionally, companies involved in divestiture need the ability to untangle which core systems are involved in which operations. For example, if a company wants to sell a piece of its business, it needs to know with certainty whether associated IT costs will disappear once the transaction is complete. Shared assets such as a data center, however, may leave the divesting company with sunk costs it's unable to recover.

All too often today, the acquisition target can't supply anything more granular than a list of hardware, software, and network elements purchased recently. Anything more specific, such as "service mapping," is likely to be either unavailable or inaccurate.



> Technology can make a significant impact on the success of M&A, from enabling an accelerated and better-informed deal process to improved post-merger integration. Company executives are recognizing this, with 84% of companies in the report agreeing the CIO should have a seat at the table.
>
> – Harvard Business Review
> "How Technology is Changing M&A in the U.S." 2018

[4] "Software Management: Security Imperative, Business Opportunity," 2018

Software license compliance

Despite the associated risks, a BSA report finds that the use of unlicensed software is still widespread. Non-compliance with software licensing agreements can lead to multi-million dollar fines, and companies such as Microsoft and Oracle frequently schedule audits shortly after major mergers or acquisitions, making compliance a time-sensitive issue.

Having a way to quickly determine whether an acquisition target is compliant with their software licenses will easily pay for itself. However, many enterprises cannot perform self-audits, because they don't have the process and tools in place to ensure that good quality data and an accurate view of compliance are easily accessible on a day-to-day basis.

Moreover, many investment bankers lack expertise on the technology side of M&A activities—they don't know what to look for or expect from granular software license information.

Quality of service

Customer loyalty is directly related to the quality of the services and solutions offered. An acquiring company will want specific metrics from its target, such as availability levels, performance, and customer satisfaction metrics like the Net Promoter Score (NPS).

Unfortunately, most companies can't quantify these metrics—their systems were built in a piecemeal manner, leading to incompatibility and a lack of transparency. As a result, changes are difficult and expensive. There's no visibility into which systems can be phased out and where the organization needs additional investments; furthermore, capital expenditures may be higher than necessary, which creates an easy win for an acquirer that can lower expenses.

Security and compliance

The acquiring company will want to know who has access to proprietary information. Furthermore, they need to understand the regulatory requirements of the products and services provided by the acquired company, and know whether they're aligned with local laws.

As the volume and volatility of cross-border deals continue to increase, these requirements will become even more important. Everything from regulatory requirements to security threats will face rapid and relentless changes, and governance risk and control programs and security measures will have to keep up. Assessing dependencies across risks, compliance, and cybersecurity issues is extremely complex and time consuming.

Using a single solution resulted in accurate compliance rates for help desk services... The implementation was successful enough that other departments, including facilities operations and HR, are requesting the tool in their own departments.

– Dave Schecklman, Chief Information Officer, Oshkosh Corp

Quantifying the impact of IT integration

Not every IT function in an acquired company needs to be merged with the acquirer. Certain pockets of IT within the acquired company may be better off as discrete entities. But how does the acquirer determine whether and when it makes sense to integrate them?

CareWorks, one of Ohio's largest managed care organizations, was acquired by New Jersey-based York Risk Services Group in 2014. Having established a highly effective shared services model, CareWorks had sufficient transparency into operations to propose an innovative solution to the integration conundrum:

- Integrate specific IT functions into a common operational shared service platform
- Baseline those assumptions against enterprise Service Level Agreements (SLAs) for three to six months
- Quantify the impact of integrating them into central IT versus allowing them to remain separate

This approach helped the acquiring company minimize the cost and disruption of IT integration.

3. Integration phase

According to a recent study from Deloitte[6], both corporate and private equity respondents ranked effective integration as the single most important factor for a successful transaction.

However, effective integration is all but impossible without visibility into vital information. The root cause of M&A transactions' high failure rate is lack of transparency—not the integration effort itself.

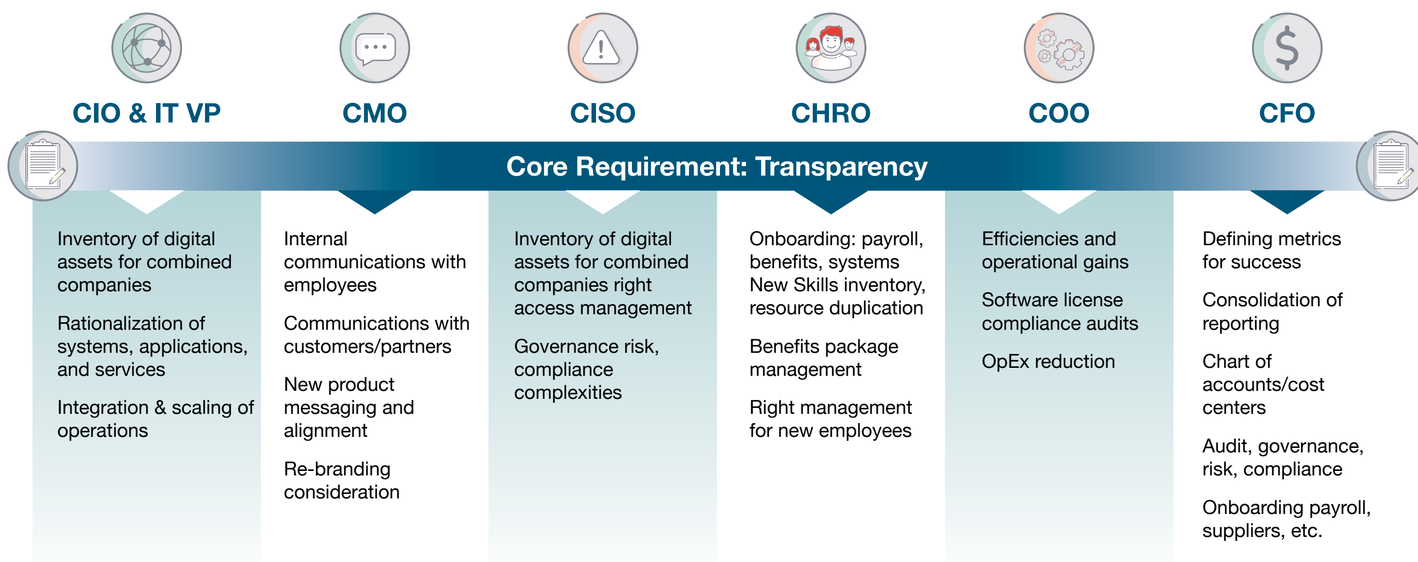
Bridging the transparency gap

We've established that transparency into information and business processes is critical to reaping the full benefit of a merger or acquisition. But how do you achieve this? How do you create an IT environment that increases transparency at every phase of M&A?

And—since the IT of the acquired company was never in your control—how much of a difference does your company's transparency make?

On the next page, you'll see how your organization can strengthen its position and deliver on its primary charter of maximizing shareholder value. And by doing so, your company can serve as a model for other organizations—perhaps even contributing to a decrease in the M&A failure rate.

> 70% of acquisition targets had compliance issues, and half of them lacked comprehensive data security architectures.
>
> – CSO.com



[6] M&A Trends 2019; Deloitte

Five steps toward transparency

A quick guide to delivering a high level of transparency during the three phases of an M&A transaction:

1. **Put IT on the M&A team.** All too often, IT is only made aware of M&A or divestiture plans after the deal has been struck. Ensuring that IT is a full and active participant in every stage will make the process smoother.
2. **Use a single system of record for IT.** A single, authoritative source of management information enables you to deliver simpler, more reliable services with minimal overhead. Just as importantly, it ensures the accuracy of your own data about IT assets.
3. **Transform IT best practices into enterprise best practices.** By standardizing Information Technology Infrastructure Library (ITIL) best practices, you can provide end-to-end visibility into all ITIL-conformant processes and infrastructure. In turn, this makes it possible to consolidate fragmented tools and legacy systems, integrate data from multiple sources, and automate processes.
4. **Manage IT services, not just IT assets.** IT is fundamentally about service delivery, not infrastructure or "plumbing." By managing IT services from end to end, you increase transparency into every aspect of the business processes served by IT. As an added benefit, you position IT as a true service provider and strategic partner to the business.
5. **Extend the concepts of IT service management to every business process.** The ultimate goal is to apply the same level of structure, best practices, and consistent service delivery you create for IT to every repeatable business process. That's the key to transparency—and a successful M&A transaction.

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