

Information Technology

Driving the full business value of mergers and acquisitions through better IT due diligence

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Due diligence is an essential component of mergers and acquisitions that are successful in the long run and contribute to high performance. A detailed and open examination of legal and financial information can help ensure that a final "go" or "no-go" decision is made based on rational analysis and not merely hype or hope. It can also help avoid the damage caused by "surprises" that can pop up several months later, making post-merger integration difficult or even compromising the value of the deal.

Due diligence activities usually are focused primarily on business and financial issues. Thus, many organizations fail to look closely enough at the information technology aspects of the deal. As a consequence, companies may put large proportions of targeted value at risk. Some organizations, for example, perform only a limited IT assessment. Another common mistake is to focus on how IT supports the pre-deal business requirements rather than how it would affect those requirements after the deal. This occurs when a company limits the scope of IT due diligence to the as-is state of the merging companies instead of the future state envisioned by the merger.

Compounding the problem is the fact that IT due diligence is often isolated from commercial due diligence, which limits the IT team's understanding of the new business strategy and

requirements. As a consequence, the newly merged company runs the risk of having an IT organization that lacks the capabilities needed to support the merged business.

As organizations become increasingly dependent on IT to improve business performance, they must expand the scope of their M&A due diligence to include an IT analysis, grounded in solid principles covering IT's importance to the deal creation logic, IT risks and opportunities, and IT's bearing on overall commercial due diligence.

The importance of IT to M&A deal creation

IT typically creates value for M&A transactions in three ways:

- Improved operations from consolidation or automation.
- Improved revenue streams from new IT-enabled capabilities.
- Better IT effectiveness.

Improved effectiveness alone can generate ongoing savings of 15 percent to 30 percent of the total pre-merger IT costs. Accenture research has also confirmed the importance of IT due diligence to overall deal value creation. In one study, for example, Accenture found that 70 percent of M&A transactions that included thorough IT due diligence were deemed success-

ful, compared with a success rate of 18 percent for those that did not follow such a process.¹ Another Accenture survey of 334 senior business and IT executives cited IT integration as the most critical factor in the overall success of a merger—above such other factors as management and leadership.² With that kind of value in play, it makes sense for companies to establish a specific IT due diligence process, conducted by a dedicated team with deep business and IT expertise.

A three-part focus for successful IT due diligence

To help deliver the full value of M&As, companies should design their IT due diligence around three principles in particular.

1. Base the extent of IT due diligence effort on an upfront assessment of IT's importance to the deal's value creation logic. IT due diligence is essential, but the level of effort depends on the IT conditions of the M&A target. A preliminary assessment of those conditions will help the team scale the IT due diligence effort accordingly.

For example, one private equity firm considered acquiring a multinational consumer goods company to increase profits through operational improvements such as better sourcing. The IT component turned out to be a potential deal breaker, because substantial investments in a large-scale systems consolidation and replacement effort would likely have been required to enable the targeted synergies.

2. Focus IT due diligence on closing requirement gaps that may hinder the achievement of the new value creation strategy. A primary focus of IT due diligence should be identifying the risks and opportunities related to the new business requirements. The goal is to derive detailed, comprehensive business requirements for IT based on the value creation envisioned for the merged company. The assessment should then focus on identifying any gaps between the existing IT state and

the future IT requirements needed to deliver the full value of the deal. The final step is to identify and put in place solutions to close those gaps.

At the private equity firm already mentioned, the IT due diligence team analyzed the critical business requirements posed by the commercial due diligence findings and, in parallel, assessed the current state of IT at the target company. The analysis indicated that the critical need for IT-enabled information transparency across the target's organization was not supported by the existing decentralized IT structure. Drawing on a thorough understanding of "must have" business functionality, as well as the team's deep IT and M&A experience, the firm identified and evaluated potential solutions. It ultimately determined that a large-scale, deal-breaking application consolidation effort was not required. Instead, the conclusion was reached that a business intelligence solution could enable most of the targeted business value.

3. Ensure integration and iteration between the commercial and IT due diligence efforts. IT due diligence should be integrated with commercial due diligence, iterating as the overall due diligence proceeds. Two reasons support the need for this integrated and iterative approach. First, IT due diligence should be performed early in the pre-deal assessment phase. The time constraints of this phase often do not allow for sequencing the work until after the commercial assessment is completed. Second, findings from the IT assessment can affect the commercial assessment. This means, however, that the business requirements for IT cannot be fully specified from the start, but will evolve during the overall due diligence process. The IT assessment should therefore take an iterative approach, gradually refining conclusions as more details become available. An important prerequisite for ensuring such an integrated approach between commercial and IT due diligence is a seamless information flow between the teams performing the two assessments.

At the private equity firm, communication between the commercial and IT due diligence teams first took place through the deal coordinator which fostered a high-level understanding of the value creation strategy. However, the IT team soon needed closer interaction with the commercial team to understand the business requirements in detail. The firm decided to remove intermediaries and connect the IT and commercial due diligence team leads directly to enable faster exchange of knowledge. The firm later completed the acquisition, in part due to a thorough IT due diligence effort that showed that adequate IT support for the new business could be achieved with feasible investments.

Closing the gaps

Market watchers expect M&A activity to continue at record levels, yet driving high performance through successful integration and deal value realization continues to elude many companies. To best assess the full value of M&A deals and align IT to the business, companies must establish appropriately rigorous IT due diligence processes that map to the identified value-creation opportunity, close IT requirement gaps for new value creation and integrate well with commercial due diligence.

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¹ "Keys to the Kingdom: How an Integrated IT Capability Can Increase Your Odds of M&A Success" Accenture, 2002.

² IT and Post-Merger Integration survey, Accenture, February 2005.