CIOs can play a big role in evaluating and executing mergers—before and after the deal is final.

**EXECUTIVE SUMMARY**

Early input from CIOs can help ensure the alignment of business and operational goals in a planned acquisition. The CIO can assess the technology assets of the target company, determine the level of effort needed to make the two companies operate as one, and identify opportunities for new business initiatives. Beyond assessing a potential acquisition, the CIO must be prepared to execute an integration strategy. Here are some best practices and key considerations for CIOs and IT departments to consider as their companies enter the mergers and acquisitions game.

You’ve heard rumblings that your company may embark on an acquisition. Before the shopping spree begins, do you, as CIO, feel well positioned to contribute to the process? Can you explain the corporate motivation behind this strategy to your IT staff? And most importantly, do you have a plan for contributing to the profitability and success of the deal?

Throughout the merger or acquisition process, challenges arise across all areas of the company, many of which depend on information systems. Competitive environments mandate that the deal be done quickly and correctly. CIOs and their IT departments can take the opportunity to become stakeholders in the M&A process.

Mergers and acquisitions don’t happen by accident. Whether the CEO wants greater market share or a division head gets wind of a competitive threat, there’s always a compelling reason for this initiative. Unfortunately, IT executives aren’t always brought into the M&A discussions at the early strategic planning stage. Perhaps there’s a feeling among those responsible that “too many cooks will spoil the broth” or that soliciting more input increases the risk that the project will be rejected. But there are compelling reasons for business technology executives to be involved early in the process to ensure the alignment of business and operational goals.

The CIO can help assess the technology assets of the target company, determine the extent and cost of systems integration efforts, and look for opportunities for the merged companies to collaborate on new business ventures.

“Many businesspeople think about mergers from strictly a cost-savings perspective, but the combination of Morgan Stanley and Dean Witter Discover, for example, was a revenue-driven merger,” says Jonathan Teplitz, IT Operations Officer at Morgan Stanley Dean Witter. “Morgan Stanley had products; Dean Witter had the channel; and the Discover card business added revenue consistency. Most people think the role of technology in mergers is to gain scale and eliminate redundancy. Given the revenue-centric orientation of our merger, we focused on areas of collaboration.”

But for companies focused on cost reductions, the CIO can also aid in the process. “In a cost-focused merger, efficient technology integration enables communications, collaboration, and cost savings throughout the merged entity,” says George Sherman, Chief Technology Architect at Morgan Stanley. This is a key determinant of M&A success, he adds. “Making decisions about the breadth and depth of the technology infrastructure and application
integration early in the merger process helps the IT staff ensure success. And corporate execs should see this ultimately as a business enabler, not a barrier.”

**Due diligence**

The due diligence team should look beyond the financial terms of the deal to identify key operations integration issues and estimate associated costs. Company culture, compensation practices, employee benefits, operations, and technology vary profoundly from one organization to another. Understanding these differences early on will highlight critical issues. It will also improve the accuracy of integration cost projections, including the tax impact and the overall valuation of the acquired firm.

The CIO should recommend the team include specialists who understand IT skills and project-development practices. For example, do the two companies share similar technical expertise or do they have complementary skills? How do these skills translate to future projects the combined company may want to embark on?

Morgan Stanley was looking at acquiring an asset management company, and the IT professionals helped evaluate its technology assets. This enhanced the evaluation of IT resources and the integration requirements.

One of the toughest challenges was making sure to ask the right questions. How would they integrate from an application and infrastructure perspective? What are their key processes for IT change and risk management? What are their financial metrics for assessing the success of technology projects? What percentage of revenue has been spent on technology? What is the IT culture? The answers to these questions helped provide a quick snapshot of the technical and cultural issues that would influence forthcoming integration projects.

The CIO should understand the technology assets of the enterprise and communicate benefits and concerns to the CFO, who must ensure that these assets are properly identified and accurately reflected in the financial reports and contract terms of the merger or acquisition. For example, the age of the IT architecture impacts the interpretation of the financial statements, amortization of capital goods, and return on investment of technology implementations. Did the seller recently undergo substantial upgrades or will an immediate and sizable investment be needed to bring its technology up to par with the acquiring company? The CIO should assess software and hardware plans to estimate cash requirements for upcoming years. Then the CFO can anticipate changes in expenditure levels. The results may directly affect pricing and contract terms.

There are no hard metrics for pricing technology assets; technology value is deal-specific. In some cases, the acquirer may see tremendous benefits in buying industry-specific databases or an advanced broadband network. In others, technology may not be a driver at all.

Bryan Finkel, Managing Director of Advanta Growth Capital LP, an early-stage venture fund, says, “We don’t value technology. We value the business based on the technology.” The underlying technology contributes 20% to the business value, Finkel says. The effective application of technology for product development, marketing, and distribution is 80% of the value, he adds. So, new technologies are only valuable when they effectively address market needs better than previous solutions.

The acquirer is often more interested in the staff that built the application than the technology itself. When a company produces a first-rate application, it’s in essence sending up a flare saying, “We have some smart people here.” For example, Verisign last year paid $25 million in stock for Nanobiz, a tiny, zero-revenue E-commerce software company. Verisign believed that this all-star development team had done something impossible and wanted them working on Verisign products.

Understanding the financial perspective on acquiring technology assets can help IT executives work with the CFO to determine optimal accounting and tax treatment. For example, capitalization of assets directly affects pricing and valuation. Capitalized software is evaluated like any other intangible or “soft” asset being purchased, such as patents and trademarks, unamortized advertising, customer lists, research and development, or goodwill. Partially completed software-development projects may be accounted for as deferred expenses or capitalized as construction in progress. In mergers and acquisitions, a potential acquirer needs to see whether there is any such capitalized software and evaluate the additional commitment needed to complete the project.

“You closely assess the intangible assets on the acquisition target’s books to understand their post-transaction expected value,” says Joseph Meth, President of Breakthrough Ventures, a financial consulting firm, and formerly a 20-year CFO with a midmarket consumer-goods manufacturer. These intangible assets may be written off at the time of the acquisition or they may be transferred to the acquirer’s books. At one extreme, capitalized software would retain its value when the target’s operations are expected to
remain independent or when you buy a company to acquire its unique strategic IT skills. At the other extreme, the acquisition may simply be attractive for the incremental sales and customer base it provides, with additional plans for supplanting its IT infrastructure with yours, thereby mandating that the capitalized software costs be written off. The economic relevance of this decision is based mostly on whether the value of these assets is incorporated in the acquisition price and whether the buyer or the seller gains the tax-deductible benefit of the write-off, Meth says.

The challenge in acquisition accounting for private companies may be to try to assign as much cost as possible to the asset with the shortest life, allowing the acquisition cost to be expensed as quickly as possible and thereby reducing the after-tax cost of the purchase. Public companies, on the other hand, may try to leave the acquired expenses on the books as long as possible, thereby producing the highest after-tax reported profit and waiving the favorable cash flow consequences of tax-deductible expenses.

Get the law on your side

Intellectual property rights are another key issue the CIO should be involved in. “All intellectual property necessary to the operation of the buyer’s intended business needs to be transferred or licensed to the buyer,” says Terri De Turris, technology practice coordinator for Clifford Chance Rogers and Wells, legal M&A advisers. If IP is licensed, the scope of the license must be broad enough to cover all necessary uses of the intellectual property, both current and future. The CIO and other key members of the buyer’s IT staff should be involved in the early stages to identify critical intellectual property assets, such as license agreements for key software, whether internally or externally developed. The IT attorneys will then determine whether the seller

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**Giving Due Diligence Due Consideration**

The value of adequate and early analysis can’t be overstated. When investigating the IT operations of a potential acquisition target, it’s critical to look beyond hardware and software. Report your due diligence findings and recommended approach to the CFO or business leader responsible for transaction decisions as soon as possible. If you need a budget or approval to launch IT integration planning before the transaction is completed, present your analysis in business terms that transcend technical requirements. Here are some key issues to consider:

**Organization:** How will the merged company be designed? Will IT management teams be combined? Is one organization more centralized than the other? How will you bridge the cultural gaps?

**Communications:** What will it take to fully integrate e-mail, voice, and wireless communications systems? Have you planned forums for discussion among the distinct IT groups?

**Finance/accounting:** How does the seller’s budget and spending compare with yours over the past five years? Look at market data expense per employee, telecom expense per employee, telecom expenses overall, spending on hardware and software platforms, and compensation and fees (internal, external, and contracted). Are there large capitalized software expenses to be written off?

**Risk management/legal:** Does the target company rely on contract help? Are there concerns regarding industry or systemic risk? What equipment is leased vs. owned? How reliant is the seller on hardware and software it doesn’t own? Is it dependent on small companies or industry leaders? What’s the status of licenses, certifications, and vendor partnerships? What exposure does the company have to systemic risks and off balance sheet liabilities related to specific technologies or vendors?

**Human resources:** What are the differences in compensation for various levels of IT professionals? How do the skill sets compare? Are there differences in policies regarding training and development?

**IT philosophy and approach:** Does the target company have a diverse set of homegrown applications or does it build on standard platforms? How easily can you get the IT information you’ll need? Is the company accustomed to “making do” or does it spend money to buy the latest upgrades? Does the target company require a substantial investment to bring IT up to your standards?
has the necessary rights in such assets to transfer them to the buyer.

De Turris also emphasizes that IT executives should review all existing vendor agreements with legal experts and indicate which relationships will be most critical to ongoing operations. All hardware and software vendor agreements should be reviewed to determine what representations, warranties, covenants, and indemnities are provided and to what extent any vendors or solution providers have limited their liability with respect to their products and services. Also, any ongoing maintenance, service-level, and support agreements should be reviewed to ensure that proper protections and support are in place and that such agreements are assignable.

"There will always be some uncertainties regarding the [acquired company's] rights," De Turris says. "So the buyer should ensure that the acquired firm has all necessary rights to the assets to transfer or license them as contemplated, and that the assets don't infringe on any third parties' rights." In addition, the target should pledge that it will perform all necessary actions to assist the buyer in securing the rights it has acquired. Finally, the buyer may want to require that the acquisition company obtain insurance to enable it to meet its indemnity obligations.

Planning for success

Effective planning begins long before the ink dries on the final agreement. The CIO should designate an integration leader and potential integration team members when the deal is 50% certain. If it falls through, you may have wasted minimal effort.

But if it proceeds, you can hit the ground running and drastically improve the odds for success.

Starting with a clear game plan and setting direction up front enables staff to work effectively and independently, rather than resolving one issue at a time. As early as possible, plan an off-site retreat with representatives of various departments and execute a comprehensive integration review, covering major topics from modifying network architecture, to data conversion, to website design.

Are the organizations really ready to pursue best practices? Does the company want to avoid major changes and disruptions for the first three months or three years? Or does the company want to make an all-out effort to integrate systems and operations as soon as possible? The answers will depend on the prevailing willingness to accept change, and again, on the driving force behind the M&A deal. Banks need their trading systems on the same platform as soon as possible. But manufacturing companies may tolerate separate enterprise resource planning and accounting systems for years while they focus on production and quality standardization.

Stuart Sugarman, CIO of Mount Sinai NYU Health, was

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**And Then There Was One**

Here are five ways that CIOs can help the company ensure success in the post-merger integration process:

- **Identify star performers** at all levels during due diligence. Is an experienced developer the go-to person for the whole programming unit? Is there an account manager who always negotiates the best terms with vendors? Do whatever it takes to keep those people engaged and enthusiastic through the transition and beyond.

- **Designate an IT-integration leader** whose full-time job is to oversee detailed plans, manage coordination, and troubleshoot issues as they arise. Allocate adequate personnel and other resources, or you will be cleaning up the mess for months or even years to come.

- **Make sure the e-mail systems and shared working directories function transparently** from day one. While you don't want to strip the acquired company's e-mail identities right away, it's critical to all business-integration efforts to have a workable means of sharing confidential messages and files.

- **Immediately deploy a merger intranet site** to provide updated employee information, comprehensive personnel directories, clear responses to frequently asked questions, and contact information for problem resolution.

- **Run an organized review of integration results and develop a playbook of tools and procedures based on merger experience.** Checklists covering tasks ranging from updating access codes to merging e-mail servers will save untold time and money for the next big deal.
charged with post-merger systems integration across five hospitals and two medical centers. Thomas Jordan, the Vice President of Information Technology, recounts their initial priorities: “The first step was to stabilize the infrastructure. We implemented standardized desktops to drive automated software distribution and reduce cost per desktop by 50%.”

Next, the team built a standard architecture of servers, desktop systems, e-mail systems, file storage, and network-attached storage managers. Now when new applications are built or purchased from outside vendors, the software can be mapped seamlessly. “This keeps us afloat and allows us to take on more projects,” Jordan says.

The IT group also executed demonstration projects such as a data repository that replaced myriad local systems built with different data structures, architectures, and application approaches, says Sugarman. The master data repository is used to collect and distribute clinical data to everyone who needs it. This increased the productivity of clinicians, enabled longitudinal studies, and established a patient-centric information platform based on one system, not five. They also developed a physician portal from which doctors can access patient records remotely, gather all available clinical information, place orders, and retrieve results—all from one system. Prior to this, these tasks required seven distinct data sources, and the physicians had to be on-site.

Both projects clearly resulted in better patient care and proved the case for integrated systems.

People fear downsizing and the elimination of redundant IT roles.

While there may be initial resistance to coordinated architecture and application development, nothing supports buy-in more than effective systems with internal and external returns.

Human resources

After the deal goes through, new considerations arise. When

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**THE 90-DAY PLAN**

While the time frames cited below may be condensed, merger and acquisition deals are often conceived and transacted very rapidly. CIOs' goal should be to maximize their contribution at each phase of the process, adding management and financial value as part of the executive team.

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<th>ACTION ITEMS</th>
<th>COMPLETE</th>
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<td><strong>FIRST MONTH: Develop a strategy</strong></td>
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<td>Meet with the CEO, CFO, and corporate development department to define the acquisition strategy. Clarify the role and value of technology assets from the companies. Does your company intend to purchase valuable software platforms or to expand market share by streamlining the operations of former competitors that are being acquired? Participate in evaluating potential target acquisitions and allocate IT department resources to assist as appropriate.</td>
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<td><strong>SECOND MONTH: Assign value to IT assets</strong></td>
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<td>Identify an IT due diligence team, including the potential IT integration leader. Oversee development of questions and procedures to ensure that their efforts are comprehensive and productive. Track costs so they may be properly categorized. Document due diligence findings, including estimated costs of technology integration. Convey key budgetary and liability risk information to the accounting, investment banking, and legal teams. IT findings may directly affect the pricing and terms of the deal.</td>
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<td><strong>THIRD MONTH: Create an integration road map</strong></td>
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<td>Start preparing an integration strategy before the deal closes. Conduct initial planning meetings as soon as legally possible. Develop a detailed integration plan, with realistic milestones, specific performance metrics, and clearly defined tasks. Assign responsibilities to support the timely and smooth implementation of the plan. Establish ongoing project management, progress reporting, and strategic objectives, backed up with meaningful incentives and rewards. Communicate, communicate, communicate! Hold regular discussions with your colleagues, your new partners, vendors, and most of all, with your staff.</td>
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people think of post-merger organizational changes, they often fear downsizing and elimination of redundant IT roles. However, in most cases, both IT departments remain intact. In fact, there's often so much work to be done that extra help is required. That said, executives who have been through the corporate merger process several times agree on the importance of attending to organizational issues first to jump-start and maintain progress.

Every CIO I've met has emphasized the same two points: figure out what the organization will look like, and make sure everyone understands his or her role.

Several years ago, a wireless telecommunications company acquired a number of local, entrepreneurial ISPs. But the value of the deal quickly eroded as talented technologists left before the broadband infrastructures could be integrated. The head network architect quit after three weeks because, in his words, he refused "to be assimilated by the Borg."

The reasons for personnel conflicts are often basic and preventable: lack of respect, a sudden change in benefits, elimination of training opportunities prized by engineers, and inflexible corporate procedures.

Prioritize human concerns and let people know where they fit into the new environment. Despite the high intrinsic worth, it's difficult to place a financial value on providing a sense of security to employees of both companies. A proactive focus on all forms of communication is key to integration success. It has been widely reported that AOL Time Warner still has two e-mail systems in place. It's completely natural that professionals are reluctant to change one of their primary means of communication. But a decision to maintain separate e-mail systems has cultural impact, reinforcing what was, rather than what will be.

If you don't have standardization in IT operations, you can't leverage the economics of managing a growing company. But while an underlying architecture supports integration, successful applications are adaptable to various needs and preferences.

Best practices

While there will be headaches and possibly even heartaches as you go through the M&A process, the most impressive results relate to fundamental improvements in operations and cost-efficiency. For example, Grant Thornton LLP, an international audit and consulting firm, is actively pursuing acquisitions to expand market share and increase leverage of the firm's internal resources. Cono Fusco, Managing Partner for Mergers and Practice Integration, says the firm's cutting-edge IT assets have increased the success of the acquisition strategy: "We depend on technology to run our business. The quality and sophistication of our IT infrastructure and proprietary tools provide a competitive advantage in approaching M&A candidates." Fusco adds that when potential partners consider the cost, aggravation, skill building, and risks involved in constructing comparable IT systems, they appreciate the potential additional value and immediate benefits resulting from merged operations.

Likewise, Mr. Sugarman of Mount Sinai NYU notes that IT standardization will not not make a merger work, but will increase efficiency by enabling the sharing of information and best practices. Improving performance and profitability translates IT integration efforts into an overall business success.

Stefanie Smith works with executives to align management, operations, and information technology to achieve priority business goals.

She can be reached at ssmith@ssmgroup.com.