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CONTROLLING IT COSTS:

Controlling IT Costs with Mergers, Acquisitions and Divestitures — Ask the Right Questions to Achieve Success

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It is often the long pole in the tent… a full consideration of IT is necessary to provide solid footing for a successful M&A event.

While the financial impact of information technology (IT) within mergers and acquisitions (M&A) events may be relatively small in proportion to the total value of the transactions, IT is often the long pole in the tent and is quite visible. Consequently, to view IT as an immaterial piece of the M&A event can be a costly mistake. A full consideration of IT is necessary to provide the solid footing for a successful M&A event.

To understand the financial drivers, several fundamental questions should be thoroughly explored. Although other questions should also be considered, addressing these basics will go a long way toward managing costs effectively.

1. WHAT SERVICES ARE NEEDED?

Most M&A events require a continuation of the technology services that were provided or received prior to the closing date. If the M&A event involves a standalone business unit, the need for IT services is more straightforward. If it does not, or if it is supported by shared infrastructure or applications, the task is more complex and may drive increased separation costs. Solid due diligence is necessary to understand the full context of the environment and to determine the services needed.

Knowing what services are needed is critical for success. Access to the right information and the right level of information, as well as the ability to interview IT subject matter experts, is essential. Look within your staff to ensure that the right people are involved and available to assist in these activities. The seller will benefit from educating the buyer's IT staff as much as possible, which will in turn facilitate needed dialogue and effective planning.

2. HOW LONG WILL THESE SERVICES NEED TO BE PROVIDED?

The buyer and seller will have different goals and views in terms of how much time is sufficient for a well-planned and well-executed separation and integration. The seller's interest will be to carve out and separate the divested entity as quickly as possible. The buyer, on the other hand, will want plenty of time to integrate the acquisition without disrupting current business and will push for longer time frames.

The question of how long services need to be provided must be answered in the context of whether the infrastructure and applications will be integrated into current operations, brought into operations basically "as is," or will only be needed until alternative solutions are deployed. Each service must be evaluated on its own merit with full understanding of its interdependencies with other services. The more interdependent the infrastructure and applications are, the more complex things will be, which will result in a longer timeline. Other factors affecting how long services may be needed include whether services are provided in-house or by a third party, whether parties need outside assistance, whether there are competing projects and priorities, and the extent to which resources and capacity are available.

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3. WHAT SERVICE LEVELS ARE REQUIRED TO OPERATE THE BUSINESS?

The current provider of services, whether in-house or sourced, will be operating to certain service levels. These levels may or may not be well-documented or well-monitored. It is primarily incumbent upon the buyer to understand what service levels are measured and how; and, in light of that information, to determine whether current service levels are sufficient. "Sufficient" may mean that a service level deemed relevant to the buyer is not provided currently or that the actual target is too low. While continuing with the current service levels is rather straightforward, attempting to add a new service level or to increase an existing metric is much more challenging. Service level changes can result in increased or decreased costs. The key to adding or increasing a service level is to demonstrate a material business need and to keep it as simple as possible.

4. WHAT CONTRACTING STRUCTURE WILL BE USED TO PROVIDE THE SERVICES?

Key considerations for the contracting structure revolve around whether services are provided in-house or whether they are partially or fully sourced — whether two parties (the seller and buyer, with services provided in-house) are involved or whether three or more parties (the seller, the buyer, and the third party providers, where services are sourced) are involved. Not only will this consideration drive the language in the transition services agreement, but it will also drive how the parties operate day to day. In addition, when three or more parties are involved, the complexity of the transaction and transition services increases, which in turn leads to additional time and costs. If the services are sourced, the buyer may need to assume the sourcing contract or to receive services under the seller's sourcing contract through a participation agreement.

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5. WHAT IS A FAIR PRICE TO CHARGE OR PAY FOR THESE SERVICES?

Again, the answer here depends on whether the services are provided in-house or sourced. For in-house services the seller most likely uses a chargeback methodology to bill internally for IT services. These chargeback rates can be used as a starting point and then evaluated for applicability for the services associated with the M&A event. The chargeback rates may need to be adjusted to account for certain services or overhead that do not apply.

When the services are provided through an existing sourcing arrangement, the existing rates will likely apply, and the opportunity to negotiate may be lessened. Whether in-house or sourced, these rates can be compared with rates the buyer is paying for similar services, or they can be evaluated by a third party to ensure that they are reasonable. If the comparison or evaluation reveals a material gap, then detailed discussions to understand this gap may result in rate adjustments. One-time costs for day-one requirements, separation, and integration must also be identified and estimated.

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6. WHAT IS NEEDED TO TRANSFER THE ASSOCIATED ASSETS?

Assets — such as hardware and software — are typically included as part of the purchase price. Other cost considerations to be accounted for are primarily associated with the transfer of leased hardware and licensed software. If the assets are managed by a third party, there may be project costs associated with gathering the needed data and providing it in the necessary format. Vendors may also require fees to transfer the assets and to cover associated maintenance.

Some assets may not be transferable and may require other actions. For leases, the vendor may require a buyout or the establishment of a new lease where the rates may or may not be the same. For software, the vendor may require new license fees. In these instances, the buyer's credit rating and buying power can have an impact on the resulting fees.

The factors discussed here represent just a few of the material drivers of IT costs associated with an M&A event that — if given full consideration and managed well — can result in a significant financial impact. Engaging the finance team early as part of the core team can help ensure the best possible outcome.

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An expert in both information technology outsourcing (ITO) and business process outsourcing (BPO), Gary applies his more than 25 years of comprehensive operations leadership and financial knowledge to benefit his clients in the areas of global application, infrastructure, BPO and merger-and-acquisition initiatives. His experience spans several business and finance industries, including insurance, banking, manufacturing, retail and third-party logistics. He is adept at managing the global complexities of off-shoring and multicurrency transactions. A Baylor University alumnus, Gary also has a graduate certificate in finance from Southern Methodist University and studied business at the Wharton School of Business. He is ITIL certified.

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