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THE PYNCH

JULY 2023: THE IMPACTS OF TECHNOLOGY DILIGENCE

Technology due diligence is a thorough examination of a company's technology assets, systems, processes, and capabilities, usually conducted during a merger or acquisition (M&A). It aims to identify potential risks and opportunities related to technology, which can significantly affect the valuation of the company and the success of the transaction.

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What is Technology Diligence?

Here are a few key aspects that are typically covered during technology due diligence:

Technology Assets

This includes examining the company's software, hardware, networks, data centers, and other technology infrastructure. It also covers any intellectual property (IP) related to technology, such as patents, copyrights, and trade secrets.

Systems and Processes

Due diligence assesses the company's technology systems and processes, such as software development, data management, IT service management, and cybersecurity practices.

IT Strategy and Governance

This involves looking at how technology is used to support the company's business strategy, how technology decisions are made, and how IT risks are managed.

Human Resources

This includes evaluating the company's tech talent, IT organizational structure, and the company's ability to attract and retain tech talent.

Cybersecurity

Due diligence should assess the company's cybersecurity measures, potential vulnerabilities, and compliance with relevant cybersecurity laws and regulations.

Scalability

It is important to assess whether the company's technology can scale to support future growth.

Compliance

This covers compliance with data protection and privacy regulations, as well as industry-specific technology regulations.

The Bottom Line

By conducting thorough technology due diligence, companies can identify potential technological risks and liabilities, understand the true value of the technology assets and capabilities they are acquiring, and plan effectively for post-merger integration.

Resisting Technology Diligence

Merger and Acquisition (M&A) due diligence traditionally focuses on financials, legal aspects, business operations, and strategic fit of the two companies. In many instances, technology is not necessarily de-emphasized but it might not get the same level of scrutiny. Here are few reasons why:

Complexity and Specialization

Understanding the technical landscape of a company can be complex and requires a deep understanding of the technology, its architecture, and its strategic fit with the acquiring company's tech stack. Many M&A teams might not have this specialized knowledge readily available.

Prioritization

Often, immediate financial and legal risks take priority over long-term technology integration concerns during the due diligence process. Technology infrastructure changes are seen as manageable post-merger issues.

Opacity

It is often difficult to gain a complete understanding of a company's technology - proprietary software, IT infrastructure, and digital assets without deeply integrated cooperation, which may not always be possible during due diligence.

Speed of the Deal

M&A transactions can often be time sensitive. Thorough technology due diligence can be time consuming and could potentially slow down the deal.

It is important to note that the emphasis on technology during M&A due diligence is increasing. This is due to the growing recognition of technology's role in determining the success or failure of M&A deals. For example, technology compatibility can affect integration costs, synergies realization, and future growth prospects.

Issues like cybersecurity vulnerabilities, compliance with data protection regulations, technology talent retention, intellectual property rights, and the scalability of technology platforms are increasingly becoming critical considerations during M&A due diligence. Therefore, it may be true that technology has historically been overlooked, the trend is shifting towards more thorough technology due diligence.

Pitfalls to Avoid

Inadequate technology due diligence during Mergers & Acquisitions (M&A) can lead to several problems. Here are some notable examples of potential failures:

Systems Integration Failures

If the acquiring company does not fully understand the target company's technology systems and architecture, integrating them post-merger can be problematic. This could lead to operational disruptions, unexpected costs, and delays.

Cybersecurity Vulnerabilities

If the target company has unknown or unaddressed cybersecurity vulnerabilities, the acquiring company could unknowingly inherit significant risks. These could lead to data breaches, regulatory penalties, and reputational damage.

Compliance Issues

Failing to properly assess the target company's compliance with relevant laws and regulations (such as GDPR, CCPA, etc.) can lead to regulatory fines and legal issues. It may also necessitate costly changes to the company's technology and business processes.

Intellectual Property (IP) Rights

If the target company's IP rights are not properly vetted, there could be hidden legal issues or disputes. For example, the company might not have proper ownership or licensing rights to critical technology or software, which could affect the company's value and strategic plans.

Scalability Problems

If the target company's technology is not scalable, or if it does not align well with the acquiring company's technology, it could limit the growth potential of the merged company. It may also necessitate costly and time-consuming technology replacements or upgrades.

Technical Debt

Inadequate understanding of the target's technical debt can lead to unplanned expenses post-acquisition. Technical debt includes outdated technology, pending upgrades, or deferred maintenance, all of which can significantly impact future IT costs and operations.

Talent Retention

If due diligence fails to identify key technical personnel and plan for their retention, there can be a loss of critical knowledge and skills post-merger, causing disruptions and delays.

To prevent these failures, a thorough technology due diligence process is critical during M&A. This requires specialized technical knowledge, a detailed understanding of the target company's technology landscape, and a clear vision of how it will fit into the acquiring company's strategy and operations.

Effective Due Diligence

Executing integrated due diligence requires careful planning, clear communication, and strong collaboration among all teams involved. Here are some steps to help you execute an integrated due diligence:

Assemble a Cross-Functional Team

Create a diverse team consisting of representatives from different areas such as finance, legal, technology, human resources, and operations. Ensure that each team member understands their role and responsibilities.

Develop a Shared Plan

Create a shared plan and timeline for due diligence that aligns all teams involved. Identify key questions and issues to be addressed and ensure they are distributed to the right people. This plan should be flexible and updated regularly as new information is gathered.

Establish Clear Communication Channels

Setup regular meetings and reporting protocols to share information and findings. This could include a shared online workspace where teams can post updates and access shared resources.

Coordinate Activities

Make sure teams are coordinating their activities to avoid duplication and maximize efficiency. For instance, if the financial team needs certain information from the target company, check to see if another team is already requesting similar information.

Review and Share Findings

As each team completes its due diligence tasks, findings should be reviewed and shared with the entire group. This allows for a comprehensive understanding of the target company and can help identify connections or issues that might have been missed by individual teams.

Evaluate Synergies and Risks

With all the due diligence information gathered, teams should work together to assess potential synergies, risks, and integration issues. This process should involve careful consideration of how the target company's different elements (financial, operational, technological, etc.) will fit into the acquiring company's strategy and operations.

Prepare an Integration Plan

Based on the findings of the integrated due diligence, begin preparing a detailed plan for post-merger integration. This plan should address any identified risks or issues and outline steps to achieve the expected synergies.

Effective Due Diligence

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Remember that integrated due diligence requires open communication and collaboration. By working together and sharing information freely, teams can gain a deeper, more comprehensive understanding of the target company, leading to better decision-making and a smoother post-merger integration process.

Integrated due diligence involves collaboration among multiple teams that each bring a unique area of expertise to the process. Here are the main types of teams that typically participate:

Financial Team

These experts examine the financial health of the target company. They analyze financial statements, evaluate assets and liabilities, assess financial projections, and review the company's financial management practices.

Legal Team

This team reviews legal matters such as contracts, intellectual property rights, compliance with laws and regulations, potential litigation, and corporate governance.

Operational Team

These professionals assess the company's business operations, including its production processes, supply chain, customer service, sales and marketing, and quality control.

HR Team

The HR team focuses on issues related to employees, such as compensation and benefits, talent management, employee retention, labor relations, and cultural fit.

IT Team

IT experts review the company's technology systems, infrastructure, cybersecurity, data management, software, and intellectual property related to technology.

ESG Team

This team (or a subset of other teams with ESG expertise) investigates the company's environmental impact, social responsibility, and corporate governance practices.

Strategic Team

Often composed of senior leaders, this team evaluates the strategic fit of the target company with the acquiring company. They consider how the merger or acquisition aligns with the company's strategic objectives and growth plans.

Risk Management Team

This team looks at potential risks related to the merger or acquisition, including financial, operational, reputational, and regulatory risks.

Technology Due Diligence Lessons Learned

Private Equity (PE) firms often focus on traditional areas of due diligence such as financials, legal issues, and operational matters during the acquisition process. While not all PE firms deemphasize technology, some might not give it as much attention due to a few reasons:

Lack of Technical Expertise

PE firms might not have the necessary technical expertise in-house to thoroughly evaluate a target company's technology landscape. This can make it difficult for them to fully understand the implications of a company's technology assets, infrastructure, and strategy.

Short-term Focus

PE firms often aim to improve a company's financial performance quickly, with a view to exit in a few years. Therefore, they might prioritize areas with immediate impact over longer-term considerations like technology infrastructure and strategy.

Underestimating Technology's Impact

Some PE firms might underestimate the impact that technology can have on a company's operations, competitive position, and future growth prospects. This can lead them to underinvest in technology due diligence.

Perceived High Costs and Time

Conducting thorough technology due diligence can be seen as costly and time-consuming, particularly if external experts need to be hired. Some PE firms may decide to deprioritize it due to these perceived barriers.

When technology due diligence is not performed well during a merger or acquisition, it can lead to a range of serious problems. The cumulative experience of my colleagues over the last 25 years is that the technology team's efforts are often compartmentalized and fail to address the following questions:

1. How well does existing technology enable core business processes?
2. What is the true capability and maturity of the IT service delivery model?
3. What will be required to meet short-, medium- and long-term demand of technology from the business based on the future go to market strategy post-acquisition?

Lessons Learned *...continued from last page*

Using a diligence playbook and having a checklist is an excellent starting point but nothing compares to a collaborative and holistic team review and report of how the target will avoid these following pitfalls:

Integration Issues

If the technology systems of the two companies are not compatible or if the acquiring company does not fully understand the target's technology landscape, the post-merger integration process can be difficult, expensive, and disruptive.

Hidden Costs

Without a thorough understanding of the target company's technology, the acquiring company might not fully account for costs associated with necessary upgrades, replacements, or maintenance (technical debt).

Cybersecurity Risks

Poorly conducted technology due diligence might fail to identify cybersecurity vulnerabilities in the target's systems. This could expose the acquiring company to data breaches, reputational damage, regulatory penalties, and significant costs.

Regulatory Compliance

Inadequate technology due diligence could miss potential compliance issues related to data privacy, data protection, and other regulations. Non-compliance could result in legal problems, fines, and reputational damage.

Intellectual Property (IP) Issues

If the target's IP rights (e.g., patents, copyrights) are not properly assessed, the acquiring company could encounter legal disputes, licensing issues, or unexpected costs.

Scalability Problems

If the target company's technology is not scalable, or if it does not align with the acquiring company's technology strategy, it could limit the growth potential and efficiency of the merged entity.

Loss of Key Talent

Technology due diligence also involves understanding the technology team of the target company. If key personnel are not identified and strategies for their retention are not developed, the acquiring company could lose critical technology skills and knowledge.

To avoid these pitfalls, PE Firms should invest in a thorough technology due diligence process following an integrated due diligence approach. This includes assessing the target's technology architecture, systems, policies, cybersecurity measures, IP rights, tech team, and compliance with relevant regulations. It is often beneficial to engage experts who specialize in technology due diligence to ensure a comprehensive assessment that verifies how well technology enables a target's core business processes.

BECKWAY

Operating Company for Private Equity

TECHNOLOGY SERVICES

GOVERNANCE & ADVISORY PRACTICE

Beckway's technology advisors lead and/or manage delivery of critical technology solutions. We are experts at crafting and enabling enterprise strategy and solution design to reduce risk and accelerate business growth.

We can support or lead the effort on:

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STRATEGIC ROADMAP ENABLEMENT

Roadmap development and implementation services including technology governance, complex program management, and PMO services. We achieve value harvesting from creation of business cases to realization of objectives.

M&A TRANSACTION SUPPORT

The Technology diligence approach is a comprehensive review of what and how technology enables people and process. We perform confirmatory diligence to assist with integration planning and execution. With adequate data, we can also engage to validate prior technology assessments.

TECHNOLOGY RATIONALIZATION / OPTIMIZATION

Rationalize technology debt, applications, and/or infrastructure. We seek synergies through optimization analysis and apply business case methodology to determine how to maximize value and accelerate business growth.

CIO ALLIANCE SERVICES

Application of governance and risk management to optimize the CIO's portfolio. We will reduce costs, improve organizational performance, and address technology dependencies and/or shortcomings with targeted improvements.

TARGET OPERATING MODEL DESIGN

Address the C-suite request to evaluate how to manage their technology organization like a business. We create an action-plan and business case to implement an optimal future state to achieve synergies and measurable results.

TECHNICAL DEBT ELIMINATION

Creation of a roadmap based on the assignment of risk mitigation and priorities. We create baseline analysis, project plans, cost/benefit analysis and lead the effort to realize the improved future state. Common examples of dept are related to software development, selection, and/or supporting architecture.

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