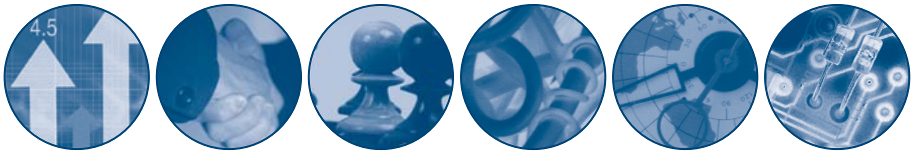

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IT Due Diligence Overview

by Mike Sisco

When senior management decides to acquire another company, all too often it focuses on financial and legal due diligence but neglects the importance of conducting IT due diligence. In most companies, technology plays a vital role in the ability to deliver products and services, improve employee productivity, and increase company profitability.

Technology is a key component of a business and should be assessed in any new acquisition. When you don't understand the stability of a company's technology or what it takes to support that technology, there are inherent risks associated with acquiring that company. A perfect example is the potential for hundreds of thousands of dollars in liability exposure due to the newly merged company not being compliant with the software in use.

IT due diligence involves learning about a business and its dependency on technology. It's about discovering risks, opportunities, and issues that have technology implications. It's *not* about diving into the depths of the technology to grasp all its intricacies and configurations. Due diligence is more about the business and less about the technology.

When assessing a company's technology, it is important to think about what you hope to accomplish going into the project. Essentially, the objective of an IT due diligence is to identify and quantify several factors, including the following:

- Risk
- Opportunity
- Business issues with technology implications
- Transition plan

A technology strategy is a key end result of a technology assessment. In an acquisition scenario, this strategy should involve the creation of a transition plan with fundamental project initiatives that help facilitate a smooth merger. In the 40-plus acquisitions with which I've been involved, two parts to an overall operational plan were developed. The first, a tactical transition plan, focuses on the first 90 days; the second, a more strategic plan, covers 12 to 24 months. These plans address the risks and take advantage of business opportunities that are discovered in due diligence.

It is vitally important to be proactive in operating the newly merged company as soon as the acquisition is completed. If you haven't conducted IT due diligence, it can be difficult to do this efficiently.

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THE PROCESS

An acquisition process usually begins with a company's letter of intent to buy another company, subject to due diligence. Once the two parties agree on the high-level terms of the merger, due diligence can commence.

Figure 1 presents an overview of the acquisition process; you can see the important role that due diligence plays in an acquisition.

A technology due diligence should be but one facet of a comprehensive due diligence performed on the new company. In addition to IT, due diligence should be performed on human resources, financial, legal, operations, and other corporate support entities of the company.

Key objectives of the acquiring company include a smooth transition and maintaining or improving the operating results of the newly merged company. To achieve these goals, you must know where the risks are as well as what issues need to be addressed in each of the company's key departments.

A thorough IT due diligence consists of five essential parts:

1. IT due diligence request list
2. Preparation for the on-site visit
3. On-site visit
4. Research and analysis
5. Transition plan

A visual perspective of an IT due diligence and assimilation process is shown in Figure 2.

1. IT Due Diligence Request List

The due diligence team presents a request list of items to the new company, requesting information to review prior to an on-site discovery visit. This request list seeks information to aid the due diligence team in learning about the new company quickly, such as an IT organization chart, project initiatives, IT department operating budget and P&L trends, planned capital expenditures, contracts, and the like.

2. Preparation for the On-Site Visit

The due diligence team should read the material provided as a result of the request list, review the company Web site, and research any available information in order to better understand the company's business and technology situation. The more you understand the new company, the more productive you will be in your on-site discovery visit.

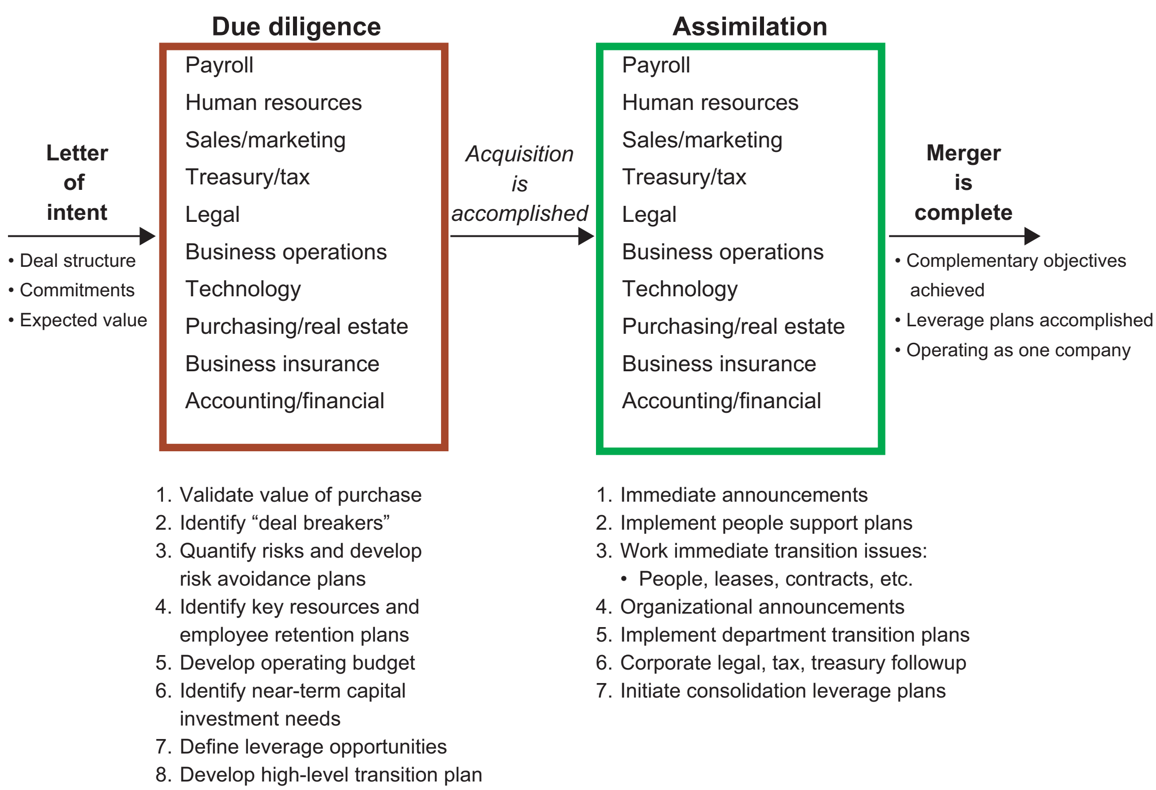

Figure 1 — Acquisition model.

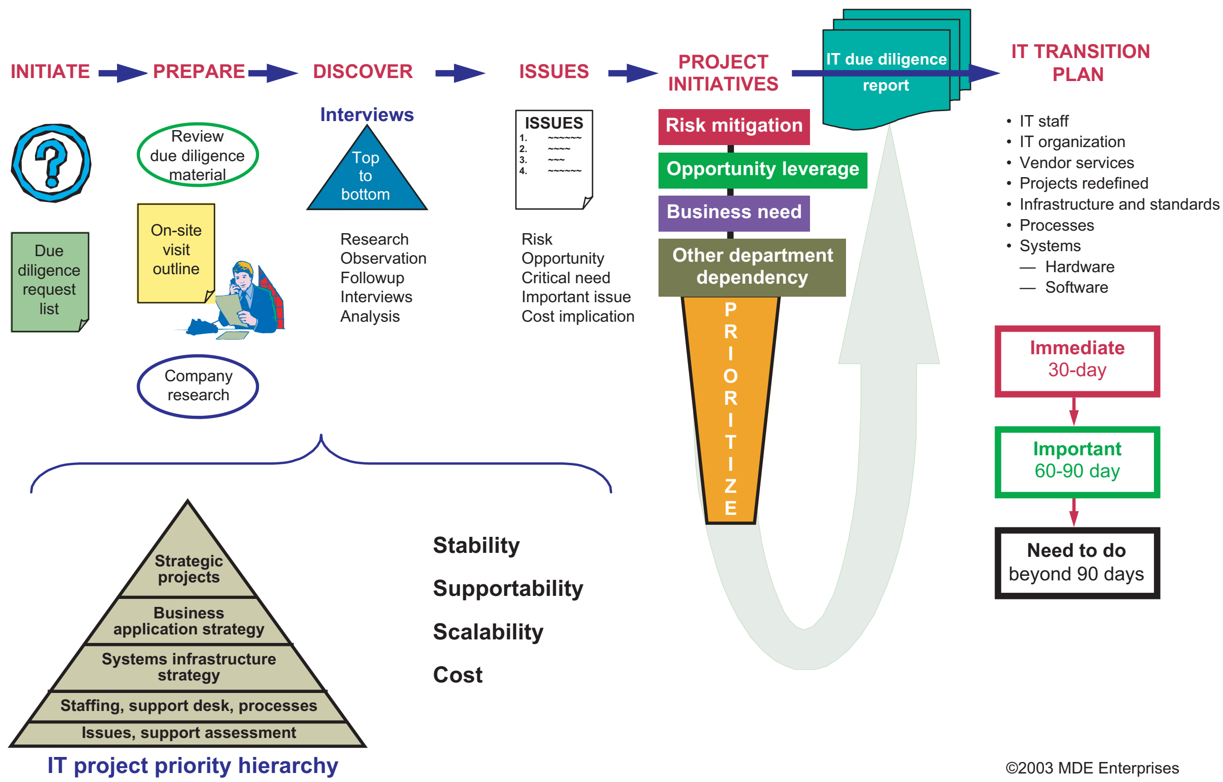

Figure 2 — IT due diligence and assimilation process.

The due diligence team should then notify the key contact at the new company and prepare him or her for the on-site discovery visit. Interview sessions should be scheduled to start the discovery process soon after arriving at the new company.

It is helpful to interview senior management first, followed by department managers. Interview key people in the IT department last; this allows you to discover true business needs and issues first without being prejudiced by the technology staff's perceptions.

In most acquisitions, there will be restrictions on who you can talk to during due diligence as well as on how you present yourself and the nature of your visit. The new company has a legitimate concern in not wanting the word to get out to employees and clients about the potential purchase until the last moment possible. In a public company, there are SEC regulations governing "insider knowledge" that prevent disclosing potential acquisition information.

3. On-Site Visit

The on-site visit is driven by interviews with senior management, department heads, and key IT staff to learn about the technology being used by the company. Discovery is a process of interviewing, observing, and researching. You are working toward an understanding of the business, the issues that exist in the business, its challenges, and so on. As you discover what the business is trying to accomplish, where its challenges lie, and so forth, you can determine whether these issues have technology implications. In particular, pay close attention to those issues with stability, supportability, scalability, and cost implications in regard to technology.

Risk and opportunity issues are special elements in discovery. Risk issues may require higher priority and may even affect the value of the deal. Opportunities are items that usually offer financial or productivity leverage and can sweeten a deal.

The on-site visit is a unique opportunity to gain a feel for the new company, its people, and its culture as well as to learn some facts of the business. Taking advantage of this early insight can help a CIO prepare for and position his or her IT organization for a smooth transition upon closing the deal.

4. Research and Analysis

After the on-site visit, the due diligence team should analyze the pertinent information and documentation and compile a comprehensive list of technology issues. This list of issues sets the stage for creating a transition plan and a strategy to manage the technology resources going forward.

Using this list as a basis, the team should then write a due diligence report geared toward senior executives. Keep in mind that senior executives are most interested in risk, capital requirements, operational expense fluctuation, leverage opportunities, and a transition plan.

5. Transition Plan

One of the most important objectives of an IT due diligence project is to develop the transition plan detailing what is necessary for a smooth transition and how you plan to operate and support the technology of the newly merged companies going forward.

A transition plan should address immediate action items that work toward stabilizing the newly acquired technology resources, especially the staff, and that mitigate or reduce any of the risks identified in your due diligence. It should include a high-level plan of initiatives that address the technology issues and business opportunities discovered during the due diligence, and it should indicate the support of other department initiatives that have technology dependencies.

Technology plays a crucial role in helping the merged companies operate smoothly as one organization; when all parties use the same services and company infrastructure support elements, the newly acquired companies don't feel so disparate, and transition is much more seamless. Also, getting basic services such as e-mail, purchasing, accounts payable, and payroll in place is an important factor in a smooth transition.

CONCLUSION

Companies that conduct a due diligence project and include key departments such as IT have a much higher success rate in merging companies smoothly. Failing to include IT and other key support departments in a due diligence effort sets up your company for surprises and a lot of pain in attempting a merger. In some cases, it may even put you out of business.

ABOUT THE AUTHOR

Mike Sisco is the founder and CEO of MDE Enterprises, an IT manager training and consulting company. Mr. Sisco has conducted more than 40 IT due diligence projects in support of new company acquisitions. For more insight into Mr. Sisco's IT management tools and services, see the MDE Web site at www.mde.net.