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## #Tech @the heart of M&A

All people, all systems go

# Welcome

Merger and acquisition (M&A) activity hit an all-time high in 2015 and we see no signs of a significant slowdown. Across all industries, deal volume was up 37 percent from 2014 to 2015, and it surpassed the \$5 trillion mark for the first time in history.<sup>1</sup> We expect sustained M&A activity in 2016-17 with M&A increasingly serving as a strategic tool to reshape core business models in the face of digital transformation.

Technology plays a huge role in M&A—and it seems to expand with every deal, bringing technology executives increasingly into the center of M&A transactions. Historically, the core mandate for technology teams in M&A was to find cost synergies and enable functional separation or consolidation. Now, as companies buy and sell technology and intellectual property and make strategic investments in increasingly sophisticated digital innovations, effective M&A requires business-savvy IT executives who can play a broader and more strategic role.

In this new series on the role of technology in M&A, *#Tech @the heart of M&A*, we share our experiences helping clients with the essential elements of M&A technology transformation today, from cost management to contract separation through application elements of privacy protection and service delivery components of infrastructure. By providing the building blocks for a clearly articulated, defined, and institution-wide approach to M&A technology implementation, we help free up technology executives for the more important and highest value-add role they can play in the M&A transaction: driving the core technology strategy in tandem with revenue growth and cost-curve optimization.

We hope these perspectives provide valuable insights and directly applicable guidance on how to approach the technology aspects of M&A. Through an end-to-end, principle-based approach, Deloitte's M&A Technology practice takes the guesswork out of operational separation or integration. We welcome your interest and feedback. We would be happy to talk with you about how Deloitte can help you achieve the goals of your M&A realization efforts.

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<sup>1</sup>"DEALOGIC - M&A STATSHOT," Dealogic, December 29, 2015, <http://www.dealogic.com/media/market-insights/ma-statshot/>

## Introduction

It has been my pleasure to steward this edition of *#Tech @the heart of M&A*. This publication encompasses some of our top M&A practitioners' latest experience and perspective from the field. It is our greatest honor to work with our clients on their most complex technology challenges and bring to bear more than a decade of experience supporting companies in this space. The M&A environment provides a unique window of opportunity to challenge and change how technology drives core business needs—and that is why we continue to be so excited about this space!

A big thank you to the authors listed after each article and for their experience and tireless work sharing their insights. A special callout to the M&A IT leadership advisors who reviewed and added perspective to all the articles—**Jason Asper, Joseph Joy**.

We hope you find this edition informative. Please do not hesitate to contact us if you have any questions or would like further information on these topics.

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## Synopsis of articles

### Applications

- **“Think logically about ‘logical separation’”** stresses that logical separation should be a front-burner issue for IT executives. When an asset sale or spin-off involves an IT transaction services agreement (TSA), appropriate tools and restrictions need to be put in place to both enable day-to-day operations and prohibit unauthorized access. The need for logical separation applies to applications, underlying databases, and data sources, but also to core infrastructure components.

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- **“Separating historical data? Look to the future”** explains how developing simple and cost-effective solutions, using the right tools and governance structure, and collaborating with stakeholders during and after an M&A transaction can significantly reduce the complexity, cost, and risks of managing historical data before, throughout, and long after an M&A transaction.

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- **“Applications rationalization during M&A: Standardize, streamline, simplify”** explores how during an acquisition, a well-structured application rationalization program can help to streamline a company’s newly expanded software portfolio and assist in achieving M&A-related synergy goals. In a divestiture, application rationalization efforts typically focus on helping a seller avoid stranded costs and defining a new, streamlined application portfolio for the carved-out organization. If the spin-off is to be a new standalone company, there are significant opportunities to leverage cloud and alternative innovative technologies; however, similarly in the case of strategic buyers, an M&A transaction may provide a unique window of opportunity to review the full existing and new application portfolio.

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- **“M&A loves the cloud”** explains how leveraging a cloud Enterprise Resource Planning (ERP) platform in a Transition Service Agreements (TSA) can be a practical, less costly alternative to traditional on-premises or hosted solutions. However, choosing a cloud ERP should involve the same thorough due diligence as the rest of an M&A transaction since each vendor has its own set of strengths and weaknesses and different approaches to managing and enhancing their product.

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- **“The human side of M&A: Selecting an HRIS delivery model”** examines how more organizations are choosing Software as a Service (SaaS) and outsourced Human Resources Information System (HRIS) models over traditional Enterprise Resource Planning (ERP) to quickly and cost-effectively stand up a post-divestiture HR function and focus their employees on the exciting future ahead.

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### Infrastructure

- **“Infrastructure services delivery planning for M&A: An ounce of prevention”** discusses how adapting a company’s current services delivery model to absorb additional M&A-related demand can help smooth the road to IT separation and integration and position the organization for Day 1 success.

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### Operating Model

- **“Cost-conscious M&A: Estimating and managing IT costs effectively”** shares perspective on how IT executives can use foresight, planning, and collaboration to accurately and effectively manage one-time IT costs resulting from an M&A transaction. Such costs include capital expenditures, operating expenses, and run-rate expenses that normally don’t occur during regular business operations and can be migrated through an M&A cost management approach.

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- **“M&A technology contract separation: Stay strategic”** discusses how a company can execute an effective and strategic technology contract separation by using an approach that frames the separation as a business event rather than a negotiation. Without sufficient preparation, both seller and buyer run the risk of incurring significant costs and violating contractual agreements.

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- **“Making a ‘poison pill’ easier to swallow: How to manage M&A-related software licensing costs and compliance risks”** cautions that mismanaging an M&A-based software re-contracting effort may result in noncompliance, penalties, transfer fees, and duplicate licensing. An antidote to the “poison pill” can be a highly regimented, centralized, streamlined approach to software re-contracting.

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# M&A IT—Applications



## **Think logically about “logical separation”**

Part of the *#Tech @the heart of M&A* series  
on M&A technology topics

During a carve-out, asset sale, or spin-off, there is often insufficient time or readiness to fully separate the Information Technology (IT) infrastructure—systems, applications, and/or co-mingled data on a server or in a database—by deal close. As a result, an increasing number of M&A deals include Transition Service Agreements (TSAs), a short-term arrangement in which the seller continues to provide services to the buyer. TSAs provide the buyer with the time required to stand up their own infrastructure over this interim period, while they provide the seller with additional time to physically separate the applications and infrastructure. However, they also pose a substantial risk for the seller as the applications and infrastructure are not separated, and this provides the seller with an unrestricted access. Key control functions (e.g., operational risk, information security, legal) often require the buyer to put restrictive controls in place for the period of the TSA. The seller and buyer legal groups often have the most important role to play in making this determination, and provide guidance on the extent of separation needed.

As IT services may comprise more than 50 percent of a TSA agreement’s scope, the seller’s and buyer’s operational leadership must address three very important questions: What is the extent of safeguards that the control functions require to be put in place to mitigate the risk of unauthorized access to each other’s data, especially since it resides (for the TSA period) in the same place? How many safeguards are enough? What are the cost implications?

**Complicating factors**

There is no simple answer to the conundrum of how much TSA-related IT security is enough—each situation is unique, with the risk profile of the industry and the companies themselves serving as influencing (and complicating) factors. A recent rash of high-profile data breaches is prompting some corporate control functions (e.g., legal, IT security, finance, regulatory, audit) to call for a complete physical separation of IT systems and databases as soon as possible after a deal closes. This is particularly true for the seller, as typically it is their IT infrastructure that they want to safeguard. However, a complete separation may take up to two years to finalize, may be costly, and may add considerably to IT departments’ workloads. In the meantime, employees at both companies need IT access—but who gets how much?

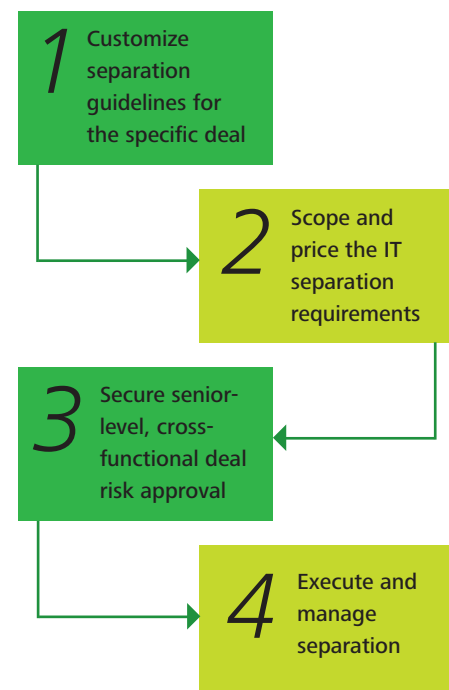
We have seen some companies adopt a “black or white” mindset when controlling TSA-related access. One risk-averse approach is to set requirements based solely on the seller’s internal third-party access/data privacy policies. While this is a reasonable place to start, operational leaders may find that meeting the full requirements of securing

third-party access (e.g., firewalls, data separation, split application layers, etc.) can be onerous, expensive, and often not feasible in a fast-paced M&A deal environment. The opposite approach is to provide access controls only around the most sensitive systems and applications, which can expose a company to internal and external cyber threats. Both approaches can be counterproductive to a deal’s goals and ultimate value. In order to minimize churn, it’s important to engage the Control Functions early in the requirements definition process to ensure alignment with business objectives.

Fortunately, a “logical separation” approach can provide IT executives with a halfway point between the two extremes by putting in place sufficient controls and monitoring processes to protect a co-mingled IT infrastructure until complete separation takes place.

**Standardized approach to determine level of separation**

Based on our experience, each provider of TSA services needs to thoughtfully (but quickly) set IT-related guidelines that are based on a holistic review of deal terms and the combined risk posture of the two organizations. Following the standardized approach detailed below can help determine the level of necessary separation:



### 1. *Customize separation guidelines for the specific deal*

We have seen that business-oriented operational or technology owners typically drive guidelines definition, with inputs from control functions, the deal team, and technology staff.

Following is a list of important considerations:

- **Deal construct**—The nature of the deal (spin-off, carve-out, asset sale to strategic or financial buyer, joint venture) can impact risk and separation considerations. In the case of joint ventures or structures where the seller retains some control in the sold entity, for example, we have observed fewer separation requirements as a result of alternative management controls.
- **Deal and TSA timeline**—The extent of logical separation varies by the deal and TSA timelines. Longer TSA durations often require more logical separation while quick TSA exits may require less. It’s also important to realize that logical separation needs to be completed on Day 1, so sufficient time should be allocated for separation or the scope should be narrowed to meet the timeframe.
- **TSA setup cost**—The two parties need to determine which funds the logical separation effort. We have seen this paid for by the seller (which often has to deal with the fallout of not separating), by the buyer (for receiving the TSA services), or as a 50-50 split.
- **Competitive nature of buyer**—Logical separation is often more extensive for companies that either currently compete with each other or are likely to do so in the future. In one instance, we found extensive logical separation for a travel business because the seller believed that the buyer might enter the same market segment in which they were operating.
- **Potential buyer TSA needs**—If all IT infrastructure and applications are being TSA’d, logical separation is much more important. The fewer services the buyer needs (e.g., if it already has an IT infrastructure in place by Day 1), the less the amount of logical separation that is required.
- **Regulatory Environment**—Data privacy laws in various countries and industries (e.g., financial services) often require extensive logical separation on Day 1. A country-by-country and industry-specific analysis can help to determine where regulatory requirements may call for more separation.
- **Legal environment**—In addition to regulatory requirements, country-specific laws (for example, use of customer/employee PII), or other legal requirements concerning sensitive information must be factored in to business decisions which will impact degree of pre-close logical/physical separations.
- **Current risk/audit open items**—Current risk/legal/audit open items and any recent attacks on the company’s IT environment should be reviewed to determine the level of logical separation based on acceptable operational risk.
- **Internal informational security guidelines**—A company’s information security guidelines are an important input to and guardrails for separation guidelines. Expect the Chief Information Security Officer (CISO) to play an important role in scoping and finalizing the guidelines.
- **Legacy approaches to deals and existing tools**—General company guidelines on deal making often include separation-related leading practices or lessons learned. Additionally, companies typically buy tools for a specific deal with the intent to use them for future deals. Reusing legacy approaches and existing tools should be considered when developing separation guidelines.
- **Not competing with ultimate goal to exit**—Logical separation is a priority that has to compete with other inflight IT projects and the eventual physical separation. This could mean a heavy burden on existing IT resources. The opportunity cost of such separation should be weighed against other IT projects and the time to Day 1.
- **IT asset logical separation suitability**—Not all types of IT assets can be logically separated. Confirm with technical teams what is operationally feasible in parallel with discussions with control functions.

Finally, when defining guidelines, it is important to build flexibility into the timeline to enforce control measures. While a majority of these controls should be in place by Day 1, others can be migrated in 30, 60, 90, or 180 days, depending on level of risk and time available.

## 2. Scope and price the IT separation requirements

The IT services addressed in a TSA separation plan should include all shared services with the divested or spun-off entity. Those services which typically receive the greatest focus include:

Area	Key components (illustrative)
Back-end infrastructure	Shared office, data network, voice network, servers and storage
End-user services	End-user devices, messaging, instant messenger
Access infrastructure	Active directory, identity access management, intranet
Applications	Single sign-on, contact center, file shares, TSA applications (forward and conveyed)

In addition, the various separation approaches and levels can be categorized into the following groups to help frame the scoping and pricing process.

Separation approach	Description
As-is	<p><b>Description:</b> The buyer continues to have unrestricted access to all seller IT infrastructure and applications.</p> <ul style="list-style-type: none"> <li>Minimal to no separation.</li> </ul> <p><b>Technical implication:</b> Co-mingled applications and infrastructure. Buyer continues to have unrestricted access.</p> <p><b>Cost implication:</b> No direct logical separation costs to be incurred.</p>
Terminate service	<p><b>Description:</b> The two companies do not set up a TSA for a service (e.g., email, payroll).</p> <ul style="list-style-type: none"> <li>The buyer moves to its own IT infrastructure and services. No separation.</li> </ul> <p><b>Technical implication:</b> None. Seller continues to operate its IT environment as-is.</p> <p><b>Cost implication:</b> No direct logical separation costs to be incurred; may incur wind-down costs to terminate technology services.</p>
Physical separation	<p><b>Description:</b> The two companies are physically separated as of Day 1 close. The buyer either moves to its own IT infrastructure or uses a physically separated IT infrastructure from the seller.</p> <ul style="list-style-type: none"> <li>High degree of separation and longer lead times to physically separate, resulting in impacts to the Day 1 timelines (if not planned well in advance).</li> </ul> <p><b>Technical implication:</b> Substantial efforts for technology resources to physically separate. For applications, effort is required to separate databases and also restrict buyer user access to applications. For infrastructure, effort needed to remove buyer users from various infrastructure components (e.g., network, emails, end user devices, etc.). Also substantial effort for historical data migration.</p> <p><b>Cost implication:</b> Substantial physical separation costs may need to be incurred prior to close to physically separate infrastructure. However, overall long-term separation costs may be reduced via a phased approach of pre-close logical separation followed by end-state physical separation.</p>

Separation approach	Description
Logical separation— user access level	<p><b>Description:</b> The two companies restrict user access to IT infrastructure and applications.</p> <ul style="list-style-type: none"> <li>• An easier way to implement logical separation.</li> <li>• Examples include: <ul style="list-style-type: none"> <li>– Restricting buyer employee admin-level access to seller servers</li> <li>– Restricting buyer employees from modifying application code by changing user access types</li> </ul> </li> </ul> <p><b>Technical implication:</b> The extent of logical separation required dictates the technical implications. For applications, it’s easier to logically separate through access controls, but it may not be possible in all instances.</p> <p><b>Cost implication:</b> Expect logical separation costs to be less at User Access Level versus full logical separation at database/application level. Will still need to incur physical separation costs post-close.</p>
Logical separation— database/application level	<p><b>Description:</b> Logical separation at a database/application level is required when user access-level separation is not enough or not feasible.</p> <ul style="list-style-type: none"> <li>• Requires substantial changes to the code base.</li> </ul> <p><b>Technical implication:</b> Requires substantial effort from technology users.</p> <p><b>Cost implication:</b> Substantial logical separation costs may need to be incurred prior to close to change database/application source code to create separation at DP/App. level. Will still need to incur physical separation costs post-close.</p>
Monitoring/ other controls	<p><b>Description:</b> Even after logically separating IT infrastructure, there may be some IT assets where logical separation is not possible or very costly. In such cases, additional monitoring controls (as requested by information security) are instituted.</p> <ul style="list-style-type: none"> <li>• Examples include: <ul style="list-style-type: none"> <li>– Active directory monitoring through real-time monitoring tools</li> <li>– DLP scanning on new company emails and network access</li> </ul> </li> </ul> <p><b>Technical implication:</b> For infrastructure, advanced monitoring is often put in place in addition to some logical separation for assets such as network, active directory, and email.</p> <p><b>Cost implication:</b> Logical separation costs will be incurred, plus any incremental IT/security tools required to monitor environments for unauthorized data access.</p>

### 3. Secure senior-level, cross-functional deal risk approval

The final step in finalizing a deal’s required scope of separation is a presentation to senior-level business, operational, and control-function (e.g., legal, IT, security, audit) leaders to secure joint risk approval. The presentation should include overall considerations, proposed separation by area, mitigating controls, and any optionality that needs steering-level approval. Following group ratification, an official deal risk document should be stored for future reference. Also, a best practice before the final risk approval presentation is pre-syndication with major stakeholders from a cost, risk, deal, and other perspectives. It is not unusual

for senior executives to ask for re-consideration in some areas, and it may take one to three plan iterations before final ratification is attained.

### 4. Execute and manage separation

Once separation guidelines have been developed and agreed to across the buyer and seller organizations, the technology and information security teams typically lead execution of the logical separation activities. The timelines for logical separation on Day 1 should account for the degree of separation agreed upon by the buyer and seller. These logical separation efforts should be carefully

managed, and appropriate IT resources should be freed up to meet the set timeframes to ensure completion by Day 1. These resources are often the same people working on other ongoing IT initiatives as well or working more broadly on the deal, so some level of resource reprioritization is also often required. It should also be noted that applications and infrastructure assets being logically separated may also be impacted by other ongoing IT initiatives and proposed changes. Hence, these simultaneous changes should be carefully assessed and managed to ensure committed-to timelines are achieved.

CIOs and other technology executives should be prepared to communicate regular status updates since Day 1 logical separation is typically on the critical path to close. While the hard work of logical separation is key to enabling legal Day 1 close, teams also need to stay focused on full separation—because that is the ultimate end goal.

#### Do’s and don’ts for logical separation

As you work through separation decisions, the following Do’s and Don’ts reflect our experience in working with our clients.

##### Do:

- Factor in Day 1 close separation requirement timelines into decisions on when to set proposed close date.
- View logical separation as a means to the eventual physical separation—minimize throwaway logical separation efforts, where possible.
- Ensure control functions have a seat at the table early in the separation planning process.
- Balance business needs and costs against legal guidelines—it’s often possible to reduce costs by going with an alternate solution (e.g., application separation through mere access controls vs. logical separation at the application level).
- Ensure comprehensive understanding of costs (pre-close logical separation plus end-state physical separation) in decision making process.

##### Don’t:

- Base your judgment purely on prior deals—each situation is unique. Regulations often change, and so does the business context. Treat each situation differently and engage stakeholders early.
- Adopt a black/white approach; balance risk-based decisions with competing business/operational and control function objectives and requirements.
- Focus exclusively on requirements from previous deals;

risks, local country laws, and IT security best practices are ever changing.

- Be compelled to logically separate each and every IT asset. Prioritize logical separation efforts—you will need your resources to work on other physical separation projects as well.

#### Conclusion

Logical separation is becoming increasingly relevant in an M&A context and should be a front-burner issue for IT executives. When an asset sale or spin-off involves an IT services TSA, appropriate tools and restrictions should be put in place to both enable day-to-day operations and prohibit unauthorized access.

A few final considerations: Avoid entering into “analysis-paralysis” mode when selecting a separation approach because there are innumerable permutations and combinations. Ultimately, the decision on “how much is enough” is a risk-balanced opinion across external and internal stakeholders. Also, set the final steering committee risk approval dates at the beginning of the process and work backwards, with clear milestone deadlines along the way. Additionally, do not let the TSA readiness and associated logical separation effort get in the way of the ultimate risk-mitigation process, the final exit from TSA services. Speed to separation remains the most important principle of all.

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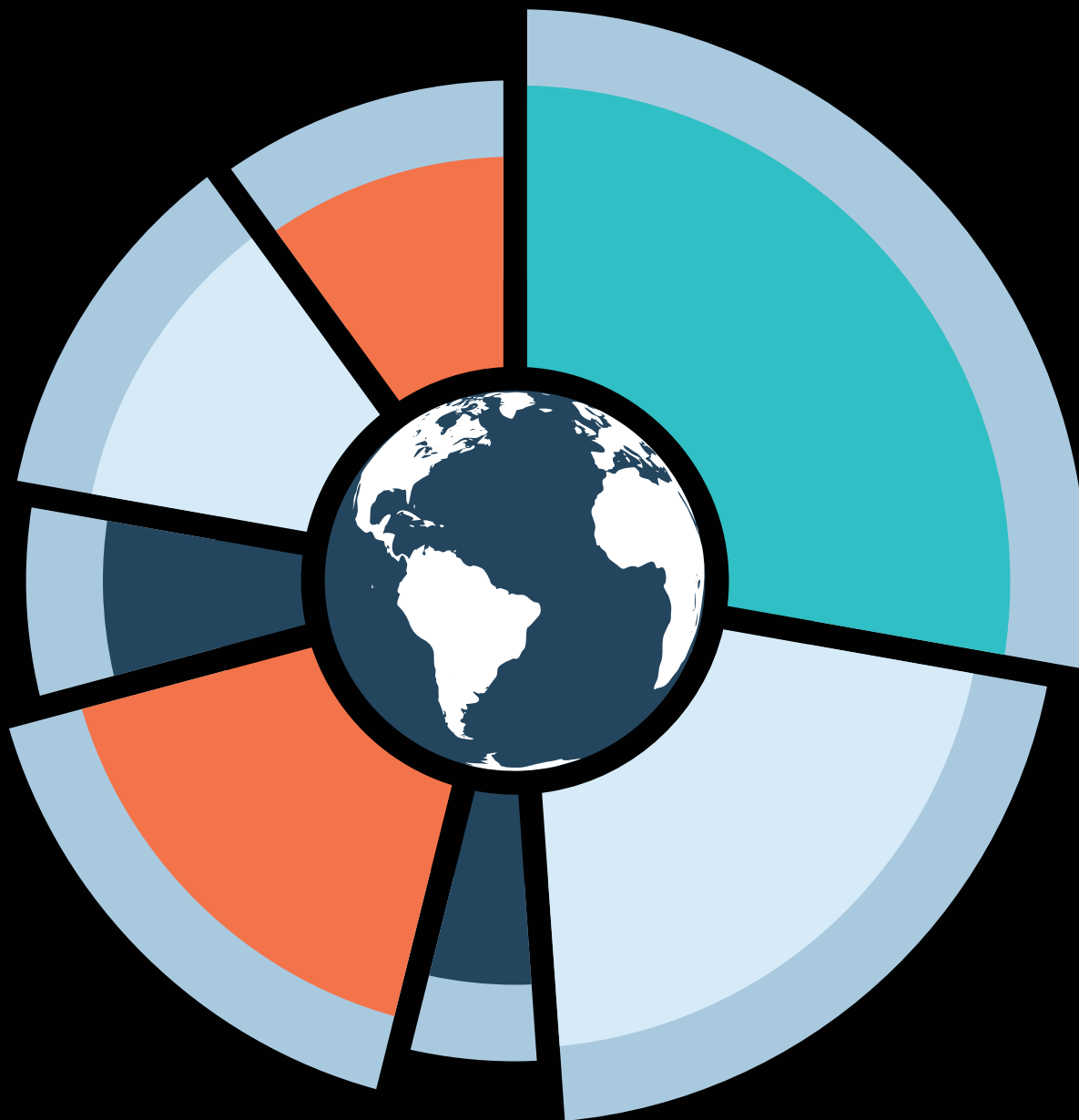
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## Separating historical data? Look to the future

Part of the *#Tech @the heart of M&A* series  
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Day 1 readiness, integration/separation planning, and major systems cutovers command the lion’s share of buyers’ and sellers’ focus in M&A transactions in the post-announcement phase of the deal. Historical data, by contrast, is often relegated to a mere afterthought. Ironically, long after the deal close, sellers and buyers frequently find themselves wrangling with major cost, resource, and infrastructure constraints to solve for final ownership of and access to historical data—especially in carve-out scenarios. Heading this problem off at the pass starts by taking a forward-looking approach to historical data.

There are important business, legal, and regulatory reasons why both sides in an M&A transaction need access to historical data pre- and post-deal close. However, some sellers underestimate the importance of early planning for data separation and management. As a result, these companies may find it difficult to quickly and efficiently locate, access, and contain data required for audit, litigation, and regulatory matters. In addition, lack of proactive planning may require significant efforts down the road to complete historical data separation to support a Day 1 or Day 2 cutover.

This article explores the factors that may complicate migrating and managing historical application data, describes potential solutions and associated considerations, and offers a high-level approach that may ease the process for both seller and buyer.

**Complicating factors and questions**

Historical data, sometimes known as “Books and Records” can take many forms: **pre-close** (owned by seller); **post-close** (owned by buyer); **online** (currently residing in applications); **offline** (archived after a period of time in systems or data warehouses); **structured** (application/database/system data); **unstructured** (spreadsheets, presentations, emails, and hard copy/paper documentation); **comingled** (mixed with data from other business units (BU)) and **non-comingled** (belonging solely to one BU). The abundance, prevalence, and diversity of historical data speak to its organizational value. However, these same factors also add to the complexity of separating, retaining, retrieving, and accounting for historical data during and after an M&A transaction. Both seller and buyer should consider the following complicating factors and key questions as they develop requirements for a historical data separation solution (see figure 1).

**Figure 1: Complicating factors**

Complicating factors	Key questions
<b>Business, legal, and regulatory environment</b>	<ul style="list-style-type: none"> <li>• What are the historical data deal requirements (e.g., Purchase Agreement, Transition Services Agreement, and Master Reorganization Agreement)?</li> <li>• What are the country-specific regulatory requirements (e.g., EU Data Protection Directive, Bank Holding Company, Sarbanes-Oxley, Works Councils)?</li> <li>• What are the legal implications of sharing data (e.g., anti-trust)?</li> <li>• What is RemainCo’s or SpinCo’s<sup>1</sup> historical data risk tolerance?</li> <li>• Will regulators require the original system of record to view transactional processing?</li> </ul>
<b>Data sensitivity, format, and retention</b>	<ul style="list-style-type: none"> <li>• What are the country-specific and corporate data retention requirements?</li> <li>• What is the sensitivity of the data categories in question?</li> <li>• What is the frequency the data will be requested for audit, legal, compliance, regulatory, and business operations requirements?</li> <li>• What format can the data be extracted in and can that data format be read without the original system in which it was transacted?</li> </ul>
<b>Technology risks</b>	<ul style="list-style-type: none"> <li>• What is the timeline for the divestiture to define their end-state IT landscape and roadmap?</li> <li>• Is there a technically viable option to retain and restore historical data without using the original application/database?</li> <li>• Is the conveying technology proprietary or end-of-life?</li> </ul>
<b>Governance</b>	<ul style="list-style-type: none"> <li>• Do RemainCo and SpinCo have the appropriate leadership structure and tone at the top?</li> <li>• Has Day 1 or other competing priorities caused a lack of focus on historical data, and is management willing to make it a priority?</li> <li>• Has analysis been conducted to determine data separation, retention, and retrieval solution timelines and feasibility?</li> </ul>
<b>Resourcing</b>	<ul style="list-style-type: none"> <li>• Will RemainCo or SpinCo retain the appropriate business and technology resources, contracts, etc., to support the historical data effort?</li> <li>• Do RemainCo or SpinCo have the appropriate subject matter expertise to support the chosen applications/database needed to view the data in a readable format?</li> </ul>

<sup>1</sup>“SpinCo” represents the business being carved out and divested from “RemainCo,” the parent company that remains post divestiture.

### No one-size-fits-all solution

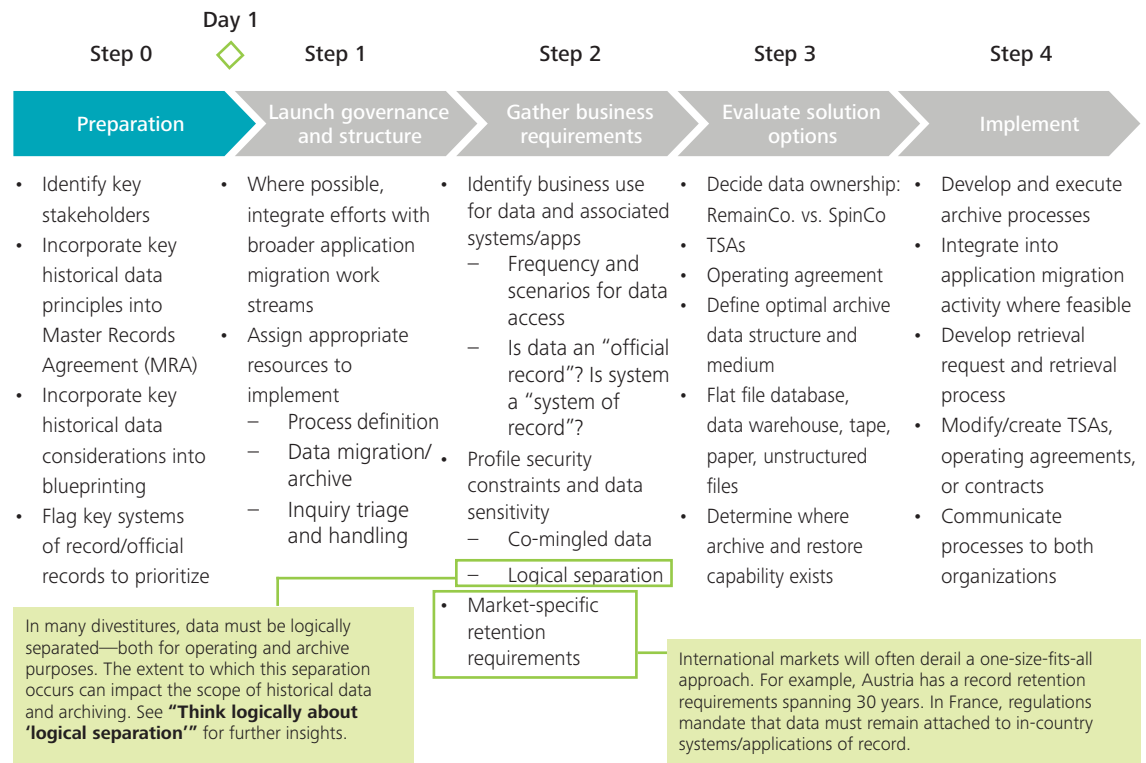
There is no one-size-fits-all solution for separating historical data during M&A—an organization’s selection can depend on deal type and terms, the volume of comingled data, and the complicating factors mentioned above. Also, the solution initially selected may change as the deal timeline progresses. Figure 2 shows a number of potential solutions and associated considerations.

**Figure 2: Historical data separation solutions**

Solutions	Works when...	Not ideal when...
<b>Leverage TSA, MRA, purchase agreement, or long-term operating agreement</b>	<ul style="list-style-type: none"> <li>Deal documents relating to historical data are well-defined and detailed</li> <li>Historical data considerations are integral to the deal structure</li> <li>Least costly option is for RemainCo and SpinCo to retain their applications and manage the historical data requirements through an operating or deal agreement</li> </ul>	<ul style="list-style-type: none"> <li>Applications used for systems of record will be decommissioned within 12-24 months of the TSA exit</li> <li>Country-specific regulations or legal implications limit this approach</li> <li>RemainCo or SpinCo don’t want to be a service provider</li> </ul>
<b>Clone system</b>	<ul style="list-style-type: none"> <li>RemainCo has subject matter expertise to support the technology stack</li> <li>Application is portable and flexible to deploy at third-party data centers</li> <li>Solution uses a non-proprietary or end-of-life system, where resources and licenses can be obtained</li> </ul>	<ul style="list-style-type: none"> <li>Key resources convey to SpinCo and contract resource that they do not know legacy technology</li> <li>Third-party data center hosting facilities require remediation of end-of-life systems prior to migration</li> <li>Solution is cost-prohibitive (e.g., standing up a mainframe environment)</li> </ul>
<b>Implement archival tool</b>	<ul style="list-style-type: none"> <li>Archiving non-proprietary systems</li> <li>Archiving technology is able to read the data without the application</li> <li>Archiving technology meets business, legal, and regulatory retention and retrieval requirements</li> </ul>	<ul style="list-style-type: none"> <li>Data is frequently needed for business operations, unless archival tool has self-service feature or retrieval process has minimal latency</li> <li>Data dictionary doesn’t exist to get data from applications to/from archival</li> <li>Time- or cost-constrained</li> </ul>
<b>Extract data to flat file</b>	<ul style="list-style-type: none"> <li>Data dictionary is readily available to make sense of data</li> <li>SQL/alternate read options are readily available</li> </ul>	<ul style="list-style-type: none"> <li>No data dictionary exists</li> <li>Application is required to read the data</li> <li>Data volume makes this approach unfeasible</li> </ul>
<b>Utilize third-party or escrow environment</b>	<ul style="list-style-type: none"> <li>Joint venture scenarios have open-ended working relationships</li> <li>Both parties are willing to enter into a long-term operating agreement and split the costs associated with systems hosting and management</li> </ul>	<ul style="list-style-type: none"> <li>Divestiture is a closed-end transaction</li> </ul>

Figure 3 presents a high-level approach and timeline to drive solution definition and implementation.

**Figure 3: Historical data separation approach**



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**Critical success factors**

There is no shortage of issues that can make M&A-related historical data management challenging and complex. However, employing a disciplined and proactive approach may help to mitigate risks, uncover constraints, streamline the process, and reduce intra- and inter-organizational conflicts—all factors that can be critical to separation success.

- **Start early.** The earlier in the M&A process that stakeholders begin considering the impacts of historical data separation, the better they can prepare and integrate solutions into their cutover planning. Among important steps:
  - Define clear guiding principles in the Master Reorganizational Agreement (MRA) at the onset of the separation to help resolve downstream conflicts and provide a framework to incorporate into separation planning.
  - Integrate historical data separation into the blueprinting phase so that all work teams consider how data will be treated for Day 1 and TSA exit (Day 2).
  - Don't "reinvent the wheel." Leverage existing systems, establish a repeatable process, and separate data by like work streams (e.g., by function, by system) to help reduce implementation cost and time.

- **Set the tone at the top.** Executive support for including historical data separation at the onset of deal planning can help to keep the issue front-of-mind as the M&A teams develop Day 1 and exit plans. Leadership should also:
  - Provide guidance around which data may be shared and draw boundaries around which data should be separated.
  - Embed an appropriate governance structure as part of a centralized separation management team.
- **Collaborate.** Multiple stakeholders from both sides of the transaction sit at the M&A table; some are there because of their business acumen, others because of their technical expertise. All play important roles in historical data separation and should work collaboratively to enable separation completion. Among important tasks:
  - Define the business requirements for historical data, understand the technical constraints and feasibility, and prioritize the most pragmatic approach.
  - Consider data security, privacy, and business sensitivity issues. Ask legal, information security, compliance, risk, and internal audit stakeholders to weigh in on the scope and implications of historical data.

- Depending on the complexity of the carve-out, ask the Program Management Office (PMO) to guide and manage multiple historical data work streams across businesses and functions.

It may seem that separating and preserving historical data requires a historic effort, but it doesn't have to. By starting early in the M&A lifecycle, developing simple and cost-effective solutions, using the appropriate tools and governance structure, and collaborating with stakeholders, the pain of managing historical data can be a thing of the past.

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## Applications rationalization during M&A: Standardize, streamline, simplify

Part of the *#Tech @the heart of M&A* series  
on M&A technology topics

Most companies tend to accumulate a large information technology (IT) application portfolio over time, especially if they grow through M&A and do not fully integrate operations and assets after each transaction. When viewed holistically, many of these applications may not align with the company’s overall M&A strategy; they were created as point-in-time solutions and don’t necessarily support post-deal, enterprise-level, business and organizational objectives. Similarly, in a divestiture context, often once the transaction closes, both SpinCo and RemainCo<sup>1</sup> may need to review their applications portfolios and rationalize to support the “revised” businesses.

An M&A event, therefore, is an ideal time for companies to examine their applications portfolio and explore opportunities to:

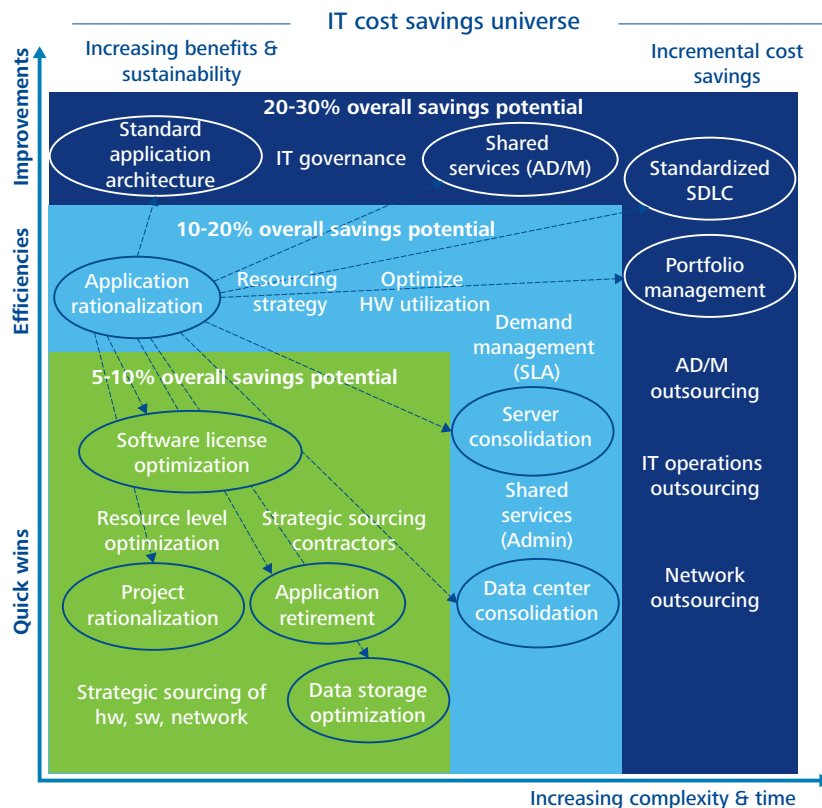
- Attain operational and cost synergies via acquisitions and integrations

- Reduce stranded costs left with the seller after a divestiture
- Standardize, streamline, and simplify their portfolio to best serve the future company and its lines of business

A proactive application rationalization program can help M&A participants—both sellers and buyers—achieve one or more of the above objectives by simplifying their portfolio and the associated infrastructure (systems and personnel) required to support it. By engaging in application rationalization, organizations can reduce costs (see figure 1), operate more efficiently, and focus on what really matters during the M&A process—legal and regulatory issues, systems and process integration, and business continuity.

This article explores some leading practices to improve the success of an M&A-driven application rationalization program.

Figure 1: Applications rationalization as part of the IT cost savings universe (for illustrative purposes)



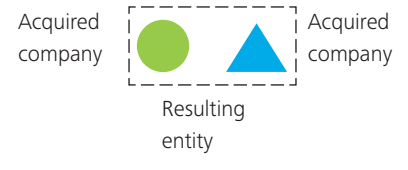
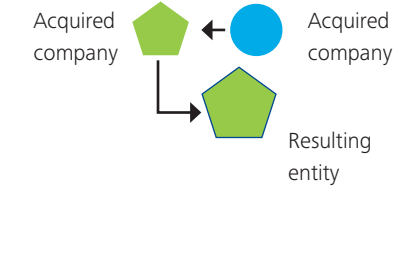
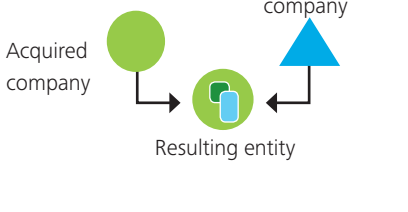
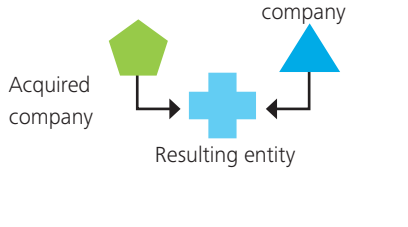
<sup>1</sup> “SpinCo” represents the business being carved out and divested from “RemainCo,” the parent company that remains post divestiture.

**Align rationalization with overall M&A strategy**

IT executives should work closely with their business function counterparts to align an application rationalization program with the company’s overall M&A strategy, as well as the selected integration approach (for an acquisition) or separation approach (for a divestiture).

During an acquisition, the purchasing and target companies must assess and integrate applications existing in each other’s portfolios. Companies typically adopt one of four integration approaches, depending on the deal rationale and synergy targets (see figure 2).

**Figure 2: Acquisition integration approaches (for illustrative purposes)**

Integration approaches	Description
<p><b>Retention</b></p> 	<p>The target company is retained almost as-is within the parent company. This strategy is typically used by holding companies and other organizations looking to branch into alternative business models.</p>
<p><b>Assimilation</b></p> 	<p>The target company is typically much smaller and its products and operations can be assimilated into the existing operations and systems.</p>
<p><b>Metamorphosis</b></p> 	<p>The acquirer (or acquirer Business Unit) and target are typically comparable in size. A best-of-breed strategy has to be agreed on within the deal’s steering committee.</p>
<p><b>Transformation</b></p> 	<p>Two companies come together and agree to fundamentally transform the way in which they do business. Such deals happen infrequently and require significant upfront investment.</p>

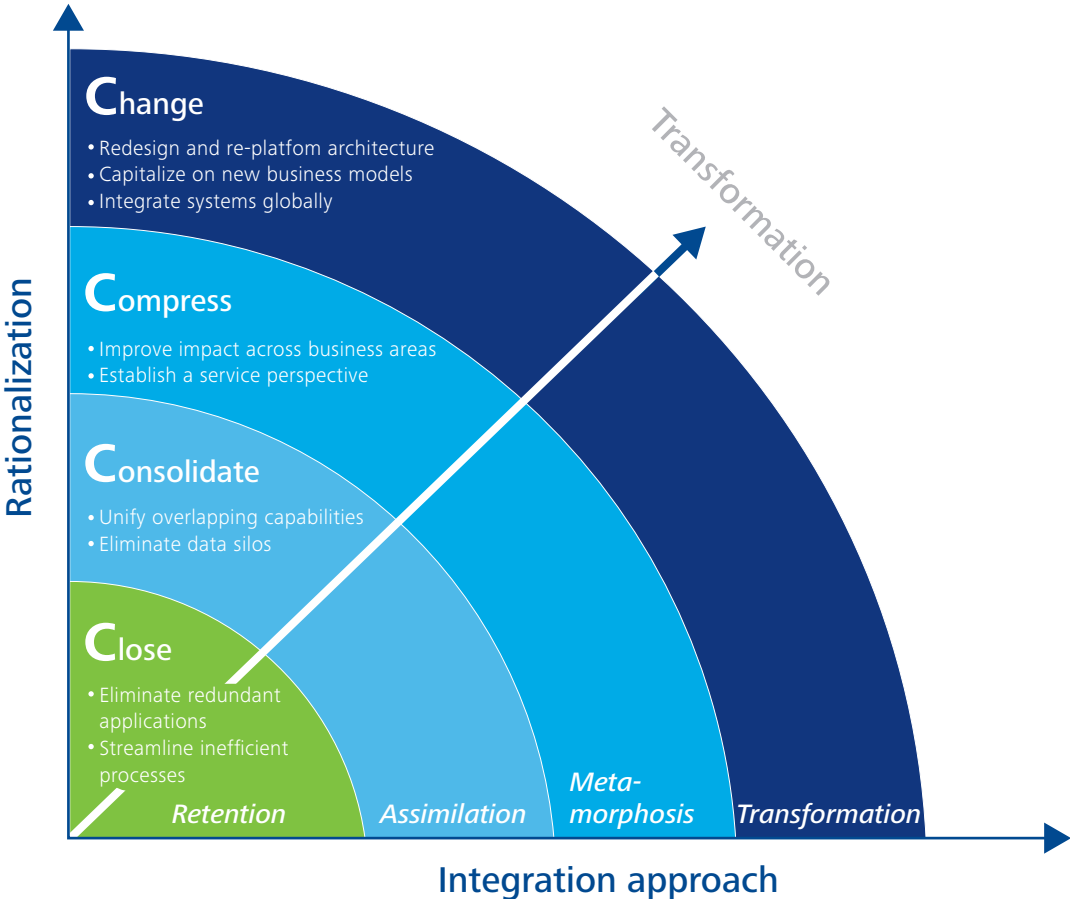
In a divestiture context, the concept behind the 4 C's also applies (see figure 3). A surfeit of applications may create a need to rationalize. The company being carved-out (SpinCo) often starts its new life with a bloated portfolio consisting of the existing applications used solely by the SpinCo and the applications it shared with the ParentCo (e.g., HR and ERP). The ParentCo, meanwhile, is frequently left with stranded costs for applications it shed along with the SpinCo. Based on the particular deal strategy, the SpinCo typically chooses one of four application separation approaches—clone & go; clone & vitiate; extract, transform, & load; or copy structure—to increase/enhance the remaining applications' alignment with the new organization's enterprise architecture. Once the separation is complete, the ParentCo can consider how to best optimize its remaining portfolio to reduce stranded costs.

**Leading practices in portfolio rationalization**

Whether a company is engaging in an acquisition, merger, or divestiture, IT executives should consider the following leading practices when developing an application rationalization program. Doing so can help to achieve synergies and reduce costs by standardizing, streamlining, and simplifying the company's portfolio after an integration or separation.

- **Partner across functions and business units.** Make systems and applications rationalization a performance metric for the executives in charge of each operational function or business unit. By doing so, they will share accountability for hitting targeted reductions. Cross-organizational partnering works well in IT organizations that may not have a charge-back model for

Figure 3: 4 Cs of application rationalization during integrations (for illustrative purposes)



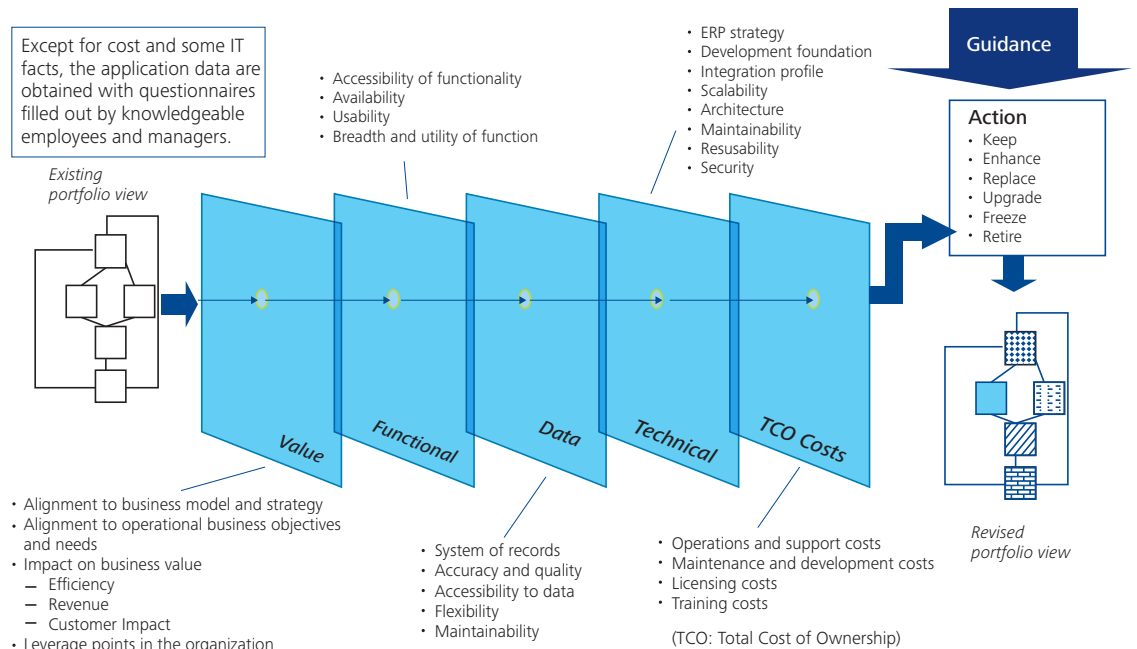


per-application spend. Where such a model does exist, partnering should happen naturally as the cost-saving synergies will be borne by the application costs in the business unit budgets.

- **Define the end-state portfolio blueprint.** Carefully assess the IT capabilities of the pre- and post-deal companies to identify the applications that will help to achieve post-deal IT synergy goals, keeping in mind the business processes that need to be aligned to maintain continuity. A series of evaluation filters should be applied

to determine the future state for an individual application and the total portfolio. Define a scoring model (see figure 4) to identify which applications need to be retained based on business value, functionality, data systems, supportability, and cost. Do not hesitate to move away from custom, internally developed applications to standardized platforms, including Software as a Service (SaaS) or cloud options that align with the overall IT strategy.

Figure 4: Application scoring model (for illustrative purposes)



- **Develop a roadmap.** Based on the analysis and the scoring model, develop a sequenced roadmap with interim objectives and target dates, taking into account influencing factors such as tax strategy, operations strategy, and market integration. Identify early adopters and low-hanging targets that can help realize the synergies with immediate results. There may be business-as-usual (BAU) project dependencies that can influence timing for the rationalization of certain applications (primarily, regulatory needs like submissions, timing of quarterly close, year-end). It is important to develop this sequenced roadmap and get it approved by IT and business stakeholders well before execution.
- **Focus on the ERP landscape.** In most companies, the ERP system is the core platform that supports the bulk of enterprise operations. Thus, a post-merger integration

plan should focus first and foremost on integrating the acquisition’s ERP system. (Based on Deloitte’s experience supporting thousands of deals, approximately 80 percent of IT M&A costs will be incurred for this aspect of the IT integration.) Other applications can be placed on a parallel integration track, taking into account the necessary upstream and downstream dependencies.

- **Establish a PMO and governance model.** Establish a strong program management office (PMO) to oversee application rationalization efforts and support alignment with business objectives, capabilities, expectations, and outcomes. Secure executive- and business-level sponsorship along with appropriate department- and functional-level participation and accountability to achieve rationalization goals. The PMO plays a vital role in institutionalizing the required level of rigor

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and consistency for program planning, execution, tracking and reporting, and managing cross-functional dependencies.

The PMO's role likely will expand considerably during the deal's execution phase to encompass program design and control, business case and communications, financial control and tracking to metrics, risk awareness and contingency planning, and read-out and reporting to the steering committee.

- **Execute and track cost savings.** A reduction in overall IT operational costs often pays for a significant portion of an application rationalization program. Companies should baseline each application's total cost of ownership to track the savings; this includes the original capital investment as well as maintenance and support fees, internal personnel costs (fully loaded), and infrastructure costs. On the program execution side, work with the leadership team and business stakeholders to define the program metrics that need to be tracked, including synergies that are realized as part of the rationalization process. Identify and agree on the tracking approach and reporting mechanisms for the program. Note that application retirements may lead to contract terminations, support consolidation, and asset reduction. Having clear-cut, planned monthly/quarterly targets for synergy realization and tracking them against the actual dispositions on a periodic basis will help to identify any leading or lagging indicators that contribute to the program execution.
- **Protect intellectual property and exposure.** In many M&A scenarios, business, legal, regulatory, and compliance may require that certain data be archived prior to retiring the legacy applications post-rationalization. Most companies try to integrate key processes and, thereby, systems to realize synergies

rapidly; they often focus on active data migration to target systems, leaving legacy records in source systems. Careful consideration should be paid to active versus historical data, which is usually determined by lines of business (LOBs) as part of the integration planning. Working closely with records management and legal functions to identify retention requirements usually pays dividends in managing corporate risk and exposure.

### Wrapping it up

An M&A-driven application rationalization program offers benefits to both buyer and seller. In an acquisition, rationalization may help to streamline a company's newly expanded software portfolio and limit/reduce redundant processes and technologies to assist in achieving M&A-related synergy goals. In a divestiture, application rationalization may help a seller avoid stranded costs and align the remaining applications with the spun-off organization's new enterprise architecture.

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While conventional M&A dogma has counseled to “transition, then transform,” emerging cloud-based Enterprise Resource Planning (ERP) technology affords executives new options to have their cake and eat it too. Cloud technology now gives executives the opportunity to simultaneously transform not only their cost structure but also their capabilities by replacing aging, capital-intensive technology with a more flexible, subscription-based operating model that can ramp up or down as business needs dictate, as well as accessing advanced cloud-based capabilities based upon best practice.

Today’s competitive business environment is driving companies to focus on core strengths and most profitable activities. Executives are increasingly looking to divestiture as a method to shed underperforming or non-core assets.

Amidst the focus on separation, it is often impractical to develop all of the required infrastructure to support the new organization, and it is common to include Transition Service Agreements (TSA) in which the seller provides post-deal, operational services or support to the buyer for an interim period of time after the transaction closes. As TSAs often include severe financial penalties for not exiting the agreement prior to the agreed upon date, there can be considerable pressure on both sides to exit quickly and with minimal impact to the business. This can be challenging, however, if the TSA includes support services for a traditional, on-premises or hosted ERP system, due to the complexity involved with ERP system configuration.

Moving to a cloud-based ERP system may help turn a potential M&A deal breaker into a deal maker. Opting for a cloud ERP solution can be a practical, less costly alternative to traditional on-premises or hosted solutions and should appeal to both seller and buyer. Requiring no hardware and nominal configuration, a medium-sized company can often be operational on a cloud-based ERP in four-to-seven months and a large international firm in approximately twice that time—both typically faster than traditional on-premises solutions—thereby facilitating a faster exit from the TSA. Considering that a cloud ERP typically provides regular upgrades, the ability to scale users, easy adjustments to system functionality, state-of-the-art security, and increased system capability, it may offer the ultimate in flexibility during a post-deal transition.

### Selecting the right ERP platform

Choosing your cloud-based ERP platform should involve the same thorough due diligence as the rest of an M&A transaction. Each vendor has its own set of strengths and weaknesses and different approaches to managing and enhancing their product. There are pure-play vendors that solely focus on cloud and traditional on-premises vendors that have ventured into the cloud space. There are vendors that require you to stay current on all releases, and others that allow you to skip a release if you decide that you don’t want to put your configuration through the system testing required to upgrade. Regardless of the vendor, there are a few key areas that a buyer should consider when selecting a cloud ERP:

- **Buy for the present**—Prioritize the system capabilities you need to get off the TSA, and plan to add capabilities and functionality, as needed.
- **Use a two-tier strategy**—If you are acquiring a new subsidiary and have no plans to fully integrate it, then having this subsidiary run on a cloud ERP system can be a viable option. This option can provide the subsidiary a level of autonomy while minimizing impact on your current on-premises ERP solution.
- **Keep it simple**—To maximize the true value of a cloud solution and minimize implementation timelines, consider adopting the standard process workflows (e.g., Accounts Receivable, Accounts Payable) inherent to the system and limit customizations. The built-in functionality is typically based upon best-in-class processes, so there may be no need to change them.
- **Understand price drivers**—There are many drivers and strategies that vendors will use to price a cloud ERP. Expect to evaluate costs driven by:
  - Users**—Typically priced in tiers
  - Transaction volumes**—Data through the system
  - Functionality**—Core functionality is typically included (e.g., General Ledger, AR, AP) but additional functionality may cost more (e.g., multi-country, manufacturing)
  - Revenue**—Percentage of annual revenue
  - Legal entities**—Some vendors utilize this as a multiplier

- **Don't forget third-party add-ons**—Even the most comprehensive cloud ERP solution may not have every piece of functionality you need to run your new business. In many cases, your needs can be addressed via an add-on or bolt-on application that is designed to work seamlessly with the cloud ERP solution. Typical bolt-on products include:

**Tax**—handling of sales tax and use tax across multiple jurisdictions

**Reconciliation**—bank, merchant, suspense, AR, AP, etc.

**Business Intelligence**—advanced capabilities

**Integration Platform as a Service (iPaaS)**—cloud-based applications that allow you to build connections between cloud-to-cloud and cloud-to-on-premises solutions

**Human Resources**—full human capital management capability

**Payment gateway**—Advances Automated Clearing House, electronic funds transfer, check printing capabilities

- **Decouple your ERP from your other infrastructure requirements**

**Minimal infrastructure required**—That data center you need to build or migrate should not be a concern. There is minimal-to-no infrastructure investment (capital expenditure) required for a pure cloud solution, beyond an Internet connection and web browser.

**Evaluate data conversion and system integration transaction volumes**—When large data volume transformation is required as part of the system integration or data conversion process, it is often more efficient to set up an on-premises-to-cloud iPaaS solution.

**Unmatched availability**—Cloud-based ERPs are hosted in advanced data centers, often with guaranteed high availability. Locally hosted ERPs generally cannot match that level of availability without significant over-engineering (along with major cost implications). There are penalties in place if your cloud ERP instance is unavailable.

### Cloud ERP isn't for everyone

While it may appear as though a standard cloud-based ERP is a good fit for any M&A scenario, there are areas and inflection points where this approach may not meet an organization's needs as well as an on-premises solution can.

**High transaction volumes can exceed current cloud capabilities**—While Cloud ERPs continue to improve their ability to handle increasingly larger annual transaction volumes, your specific volume needs may dictate either an on-premises solution or a cloud solution with multiple instances of cloud software. When developing your ERP solution architecture, you should consider working with your vendor to understand what counts as a transaction; determine your overall data and transaction volumes; identify the appropriate level of integrated financial reporting the organization requires; and decide if the organization needs a multiple-instance solution (anticipating that software and hardware advances will increase transaction volume capacity and capabilities over time).

**Subscriptions can get costly**—As mentioned earlier, a cloud subscription allows you to ramp up or ramp down costs based on your business needs but you pay for that flexibility. At a certain point your business may reach a size where a subscription to a cloud ERP may no longer be cost-effective. When developing your business case for cloud services, it is important to identify the inflection point where an on-premises solution becomes a more practical option.

**Storage isn't free**—In a cloud environment, you pay for storage. This can get expensive with the inclusion of maintenance costs and storage device upgrades. If you expect to consume large amounts of storage (10 TB or more) or are required to store historical data for a significant amount of time (7+ years), you should develop an archiving strategy or be prepared to pay your ERP provider for high-availability storage.

### Harnessing the power of cloud ERP

Cloud capabilities are enabling many organizations to fundamentally change the way they operate and to move from traditional, on-premises, large back-office infrastructure to an on-demand model.

Cloud-based ERPs have advanced in the past 15 years to a point that they now regularly compete head-on with traditional on-premises solutions. By selecting a cloud solution for a TSA, both the seller and buyer gain state-of-the-art technology, a subscription service with unmatched flexibility to grow with each business, and often zero-to-minimal infrastructure needs. Cloud ERP may truly be a cheaper, faster, and better solution for some post-M&A implementations.

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## The human side of M&A: Selecting an HRIS delivery model

Part of the *#Tech @the heart of M&A* series  
on M&A technology topics

An important priority for organizations engaged in a divestiture is to quickly and cost-effectively start up and deliver human resource (HR) services to enable a smooth employee transition from parent company (RemainCo) to a new organization (NewCo). Many NewCos are accustomed to relying on the RemainCo to provide HR and other back-office processes, services, and systems. Due to this previous dependence on RemainCo and the perceived need to create something new, NewCos may leverage the divestiture as an opportunity to select and tailor their HR Information Systems (HRIS) to their specifications and needs as a new organization. While doing so, they should focus on minimizing cost, mitigating business disruption, and managing a short time-to-close window. It is important, therefore, to select an HR technology strategy and HRIS deployment model that will meet NewCo’s strategic, operational, and employee needs.

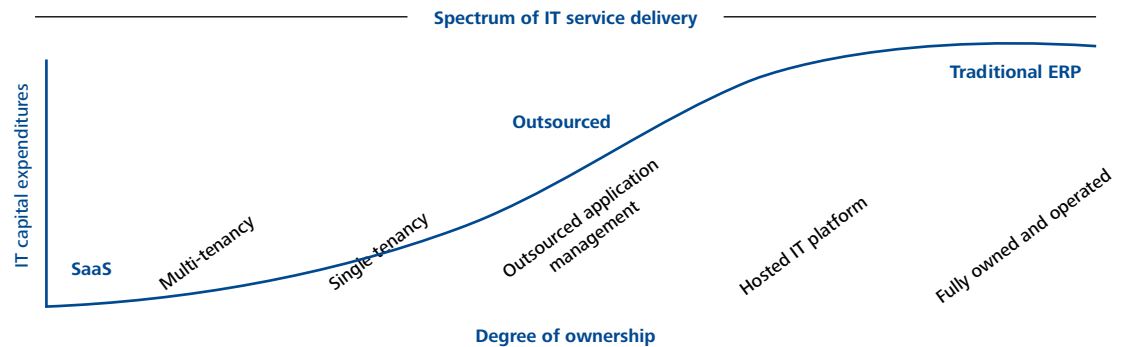
**HRIS deployment model options**

In addition to client-specific considerations, a divestiture environment has a number of recurring factors that tend

to heavily influence HRIS technology and service delivery model decisions. For example, when defining the HR Service Delivery Model strategy for Day 1 and Day 2, a NewCo should assess its current-state HR operating model and determine which process and technology changes and which deployment approach (local, regional, global) would help optimize the future-state HR organization’s efficiency and effectiveness. This process should be done in tandem with developing NewCo’s overall enterprise IT strategy to align HR and broader technology decisions and enable synergies with vendors around cost, service, and interfaces (for example, general ledger, travel and expense, and financial consolidation processes).

Before analyzing some common HRIS selection considerations in a divestiture environment, it is helpful to understand the differences among the three major HRIS system delivery models: Software as a Service (SaaS), outsourced, and traditional Enterprise Resource Planning (ERP) (figure 1).

Figure 1:



**Software as a Service (SaaS):** In a SaaS environment, the HRIS solution is fully hosted and managed by a third-party software vendor who is responsible for the application, the infrastructure, and ongoing support. The characteristics of a divestiture have made SaaS platforms a popular choice for companies looking to start up their HR function quickly and cost-effectively. In addition, SaaS platform functionality can be enhanced over time because vendors generally release solution updates two to four times per year.

**Outsourced:** In an outsourced model, the organization engages a third-party vendor to supply the system software, hardware, and a range of support services (such as payroll processing and HR administration) under a single contract.

**Traditional ERP (On premises):** In a traditional ERP model, the organization owns and maintains the hardware and infrastructure. Software licenses are purchased outright for a set fee based on employee population and module scope. Software configuration, support, and enhancements are managed, developed, and tested internally; this gives the organizations the highest level of control when customizing the HRIS solution.



### More organizations are choosing SaaS and outsourced HRIS models

Industry observations and Deloitte's work with companies engaged in divestitures with 100-8,000 employees have revealed an important trend: Over the past three years, HR technology selections during a divestiture have moved away from ERP models to a fairly even split of SaaS and outsourced solutions. Selection decisions typically hinge upon several recurring considerations (figure 2).

Figure 2:

Consideration	Why it is important	ERP model	SaaS and outsourced models
<b>Transition Services Agreements (TSAs)</b>	RemainCos typically try to minimize TSA services and push for quick exits from TSAs, creating urgency to quickly launch the HRIS solution.	<ul style="list-style-type: none"> <li>• May require longer implementation timeline due to need to set up hardware and infrastructure solutions in addition to configuration/customization</li> </ul>	<ul style="list-style-type: none"> <li>• May require shorter implementation timeline due to use of vendor's existing hardware and infrastructure; focus is on configuration</li> </ul>
<b>Time to close</b>	The structure of many divestiture deals includes a short time to close and limited or no post-close RemainCo TSA support.	<ul style="list-style-type: none"> <li>• Generally requires longer implementation timeline, which may not be compatible with a deal structure that includes a short time to close and limited or no post-close TSA support</li> <li>• Requires highly skilled resources that the NewCo may not have in house</li> </ul>	<ul style="list-style-type: none"> <li>• Provide opportunity for single contract for technology and outsourcing services ( payroll outsourcing, for example), eliminating the need for the NewCo to build those capabilities in house</li> <li>• Can leverage the third-party provider's established processes, controls, and personnel</li> </ul>
<b>Timing of capital expenditure</b>	Newly spun-off companies may not be able to afford directing a large capital investment away from the business, making the payment schedule and the associated cash flow impact an important consideration.	<ul style="list-style-type: none"> <li>• Potentially has higher upfront capital costs for hardware and software licensing</li> <li>• Is typically paid for out of the capital expenditure budget rather than the operating budget</li> </ul>	<ul style="list-style-type: none"> <li>• May require smaller upfront investment; just implementation and subscription costs</li> <li>• Are typically paid for out of the operating budget rather than capital expenditure budget</li> <li>• Payment terms differ by vendor; some begin charging for subscriptions at the time of contracting, not go-live</li> </ul>

Consideration	Why it is important	ERP model	SaaS and outsourced models
<b>Total Cost of Ownership (TCO)</b>	There is often pressure on the NewCo to demonstrate value quickly and with fewer resources than the RemainCo has at its disposal.	<ul style="list-style-type: none"> <li>Often has a higher TCO due to cost of infrastructure hosting, data security, and hardware maintenance</li> </ul>	<ul style="list-style-type: none"> <li>Often have a reduced TCO and a continual upgrade model to deliver the latest functionality</li> <li>Transitions responsibility of managing ongoing operations to the vendor, reducing the NewCo's need to maintain a large HRIS service delivery team</li> </ul>
<b>HR operating model</b>	The RemainCo may retain the highly skilled and historically scarce technical resources (application developers and database administrators).	<ul style="list-style-type: none"> <li>Generally necessitates a higher level of technical resources to manage, develop, and test configuration and enhancements</li> <li>Depends heavily on IT for functional and technical support</li> </ul>	<ul style="list-style-type: none"> <li>Can reduce dependency on internal IT because vendor manages upgrades, including testing</li> <li>A SaaS model still requires some level of skilled HRIS resources to support vendor upgrades</li> </ul>

**HRIS system implementation and management challenges**

Implementing and managing a SaaS or web-based/outsourced HRIS model are both relatively easy compared with a traditional ERP model; however, organizations still may encounter some pitfalls and challenges.

**SaaS delivery model considerations**

**Contracting and fees:** Some vendor contracts stipulate that billing will begin the first time the client accesses the environment. This billing model can be taxing to a NewCo's cash flow when it's trying to mitigate pre-Day 1 expenses. Also, the NewCo HRIS set up may take place before the actual NewCo is legally established, again presenting a cash-flow risk. An organization should clarify the billing process early in the delivery model selection process.

**Application integration:** A SaaS HR solution likely will have to be interfaced to numerous in-house and third-party applications. An organization should determine which integrations are delivered and supported by the vendor and which tools are available for custom integrations.

**Solution roadmap:** In a SaaS environment, the product's roadmap is as important—if not more important—than its current capabilities. An organization should verify that its priorities are aligned with the roadmap.

**Test environment:** SaaS providers tend to limit the number of non-production environments. Multi-phased deployments may present challenges, so an organization should evaluate the testing strategy to determine the correct number of environments.

**Release management and post-Day 1 solution management:** An organization should proactively plan for new product releases during the HRIS implementation, as these can alter implementation timelines (for example, a release during User Acceptance Testing). To aid solution implementation and ongoing management, employee hires should include individuals with the capabilities to manage solution configuration, integration, and reports. And because many SaaS solutions require annual maintenance services (AMS) to update or deploy new functionality, having knowledgeable in-house staff may mitigate the annual expense of a third-party provider performing these tasks.

**Outsourced delivery model considerations**  
**Contracting and service level agreements (SLAs):** During the contracting process, it is important to prioritize the negotiating and contracting process for HRIS SLAs, solution governance, and defined escalation path for service challenges. If engaging with multiple third-party vendors for HR services, SLAs should account for cross-functional and cross-services items.

**Vendor business and delivery model:** Some outsourcing firms position themselves as a “one-stop shop” for a company’s HRIS and HR administration services. However, these services actually may be managed by various vendor teams so it is important to clarify and understand the vendor’s business and delivery model.

**Application integration:** Similar to SaaS HR solutions, outsourcing models will need to be interfaced to numerous in-house and third-party applications. The organization should determine which integrations are delivered and supported by the vendor and which tools are available for custom integrations.

**Business strategy alignment:** An organization should communicate its business objectives and outsourcing strategy to all vendors and provide documented processes and workflow to mitigate potential service gaps.

**HR services delivery model:** During vendor selection and implementation, an organization should define and validate the Day 1 HR service delivery model to enable clear understanding of which services will be retained versus outsourced. If outsourcing a large portion of back-office, core HR services in addition to HRIS, it is important to consider the full spectrum of HR processes (HRIS linkage to payroll, inclusive of payroll administration, tax services, and garnishment payments) to manage cost and drive operational efficiency.

In a typical divestiture, HRIS implementation time frames are short and the NewCo’s capacity for capital expenditures may be limited. After weighing these and other considerations, many organizations are choosing SaaS and outsourced HRIS models to quickly and cost-effectively start up the HR function and focus their employees on the exciting future ahead.

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# M&A IT—Infrastructure



## **Infrastructure services delivery planning for M&A: An ounce of prevention**

Part of the *#Tech @the heart of M&A* series on M&A technology topics

Your company has just entered into an M&A transaction and you immediately begin to compile a lengthy, daunting list of the divestiture- and/or integration-related changes that your information technology (IT) infrastructure may require: separating or migrating applications and assets, building new data centers, reorganizing operations, retaining/restructuring talent, and more.

One important area that merits close attention is IT infrastructure service delivery. Surprisingly, IT leaders often don't spend as much time as they should thinking about how their infrastructure services are delivered, even if that infrastructure is the backbone upon which the entire IT service delivery runs.

As Benjamin Franklin said, "An ounce of prevention is worth a pound of cure." This adage certainly applies to infrastructure services delivery planning during an M&A transaction. Understanding how your current delivery model should adapt to absorb additional demand stemming from M&A activities is critical to a successful Day 1 transition. Inefficient service delivery can slow IT transformation and threaten Day 1 readiness for the entire company. In a separation, it can also greatly increase the number of Transition Service Agreements (TSAs) and, thus, the capital expenditure required to cover IT services that cannot be separated by the close date.

To prepare your IT infrastructure to manage an M&A-related services delivery load (e.g., requirements intake and server/database provisioning), you should consider the need to implement some or all of the following steps:

- Conduct a readiness assessment and shore up gaps in the delivery model
- Compile an inventory of services required to support transaction-derived activities
- Consider leveraging cloud infrastructure capabilities—Infrastructure as a Service (IaaS), Platform as a Service (PaaS), or Software as a Service (SaaS)—to expedite delivery, reduce risk, and manage cost

- Partner and communicate with business and application teams on infrastructure delivery
- Measure and control the delivery of services

### Ways to prepare for M&A-related infrastructure services delivery

Steady-state infrastructure delivery excellence does not ensure a company's readiness to support the unique demands of an M&A transaction. A separation or acquisition creates major disruptions to IT organizations and increases the demand for IT infrastructure services by an order of magnitude. Immature service delivery models can compound infrastructure limitations and quickly bury IT organizations. Even companies with more mature delivery models are often unprepared to meet an M&A transaction's additional needs. Activity-focused problems can manifest themselves in a number of ways; both seller and buyer will likely have to make adjustments. For example:

- Infrastructure teams may not be properly staffed to manage transaction workloads while maintaining focus on delivering "run-the-business" activities
- IT organizations are often not ready to support the accelerated scaling, provisioning, or delivery required
- Infrastructure services delivery may be delayed because teams do not have a clear understanding of requirements and timelines, or they do not have the appropriate tools to meet the aggressive timelines
- Application teams, particularly on the buyer side, may not have a clear understanding of how to request the new infrastructure services
- Resources may not be prepared to provide status and updates to address additional deal-related scrutiny, taking time away from valuable delivery activities

In contrast, delivery models tuned for an M&A transaction can speed up services delivery, facilitate resource management, increase visibility into project progress, and quickly identify areas of concern. Through our support of many M&A transactions, Deloitte has identified five steps to facilitate infrastructure service readiness. This is not an “all or nothing” proposition. Each step operates independently but all reinforce each other. If your company is already strong in one area or decides to move in a direction that doesn’t require a specific step, you can still craft a robust approach that meets your M&A transition needs.

### 1. Conduct a readiness assessment and shore up gaps in the delivery model.

To determine transition readiness, you should assess your delivery model’s maturity and preparedness for transaction activities. Establishing a baseline for current service delivery capabilities and understanding M&A transaction requirements can help you fine tune the model (people, processes, and tools) in advance of transition activities. Typically, preparedness is assessed around a few key dimensions:

- *Requesting services*—What is the baseline catalog used to request services and how widely is it adopted?
- *Delivering services*—What adjustments, if any, to the current service level agreements (SLAs) will be needed to support the unique requirements of the M&A transaction? How can transaction-related work be put in a different, potentially prioritized, queue?
- *Flexibility and scalability*—What alternate service delivery models (e.g., IaaS and PaaS) should be considered to address scalability, cost variability, and delivery flexibility?

Once the analysis is complete, your IT organization can create a roadmap for implementing infrastructure service delivery improvements while aligning with M&A-related requirements and timelines. Speed is of the essence, so prioritizing activities that will have the greatest up-front impact on services delivery is imperative (i.e., service request process improvements could be more important than status reporting changes).

### 2. Compile an inventory of services required to support the integration/separation.

Compiling an up-front inventory of infrastructure services should help avoid surprises later. Without a comprehensive view of existing services, you may find it difficult to determine the resources you will need to execute upcoming

work; also, you may be unable to spot where that lack of knowledge might pose program delivery risks. Getting the resource demand accurate is important because it feeds directly into infrastructure cost projections. Engaging both seller and buyer application teams to compile a full inventory of required services improves project planning and collaboration.

### 3. Consider leveraging cloud infrastructure capabilities (IaaS, PaaS, or SaaS) to expedite delivery, reduce risk, and manage cost.

Even companies that possess a solid infrastructure delivery model need to manage the time and capital costs of deploying infrastructure for an M&A-generated “new” business. This often requires physical hardware installation, network and operating system build-outs, database installs and/or consolidations, and more—a process that can take months. Opting for a cloud infrastructure can shorten your infrastructure delivery time, free up critical resources, and reduce capital costs.

Growing numbers of companies are taking advantage of a transformational event such as an M&A transaction to explore opportunities using newer technologies like the cloud. Leveraging a cloud infrastructure’s self-service capabilities may reduce deployment time to a matter of hours instead of weeks or months. It may also free up valuable human capital to focus on the M&A transaction’s more strategic activities. For a recent client divestiture project, Deloitte established a self-service cloud environment that enabled requesters to directly provision the servers they needed.

Cloud-based IaaS options can help companies move from fixed capital costs around their IT infrastructure footprint to a more “pay by the drink” (capacity on demand) variable cost model. For instance, it can be difficult for a company accustomed to operating as a single entity to estimate how much capacity will be needed to run distinct systems after a separation. If requirements are underestimated, the organization can experience scalability issues with system load and storage. On the other hand, if capacity requirements are overestimated, valuable capital may be wasted. IaaS resolves this problem by enabling rapid capacity scaling for CPU, storage, and memory. This approach also shortens the planning cycle because it helps reduce the need to precisely estimate capacity requirements up front.

One other advantage: By leveraging an external cloud, a company can convert traditional capital expenses into operating expenses. This may be particularly important when trying to manage an expensive divestiture's up-front, one-time costs.

#### **4. Partner and communicate with application teams on infrastructure delivery.**

Partnering and communicating throughout an M&A transaction are sometimes overlooked by IT-focused staff, but they are important elements in a successful infrastructure separation program. Don't just inform; involve and educate. Take ownership to help ensure that all stakeholders have a firm understanding of the processes, roles, and responsibilities required for service delivery. This will help resolve process breakdowns before they occur, reduce fire drills, and increase downstream customer satisfaction. Collaborative work processes and regular communication are particularly important in helping application teams understand infrastructure requirements and responsibilities. Project leaders should consult with application teams in an M&A transaction's requirements-gathering and prioritizing phases.

#### **5. Measure and control the delivery of services.**

That which gets measured gets done. The M&A and IT teams should establish processes to clearly measure and control services delivery against SLAs and project plans during and after the transaction. At the project level, measurements and controls can help identify discrete infrastructure deliveries that may put critical path items at risk. At the program level, they can help uncover problems in the service delivery model by highlighting patterns of service types that are commonly past due. Once identified, this can enable effective problem reporting, empower proactive issue resolution, and reduce program risk.

The stakes in an M&A deal are high for both seller and buyer; however, by properly planning for infrastructure services delivery early in the transaction, you can smooth the road to IT separation and integration and position both companies for Day 1 success.

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M&A IT—  
Operating model



## Cost-conscious M&A: Estimating and managing IT costs effectively

Part of the *#Tech @the heart of M&A* series on M&A technology topics

One of the major tasks that company leaders typically assign to information technology (IT) executives during an M&A event, be it an acquisition or a separation, is to provide an estimate for one-time IT costs resulting from the transaction. These costs typically include capital expenditures (capex), operating expenses (opex), and run-rate expenses that normally don't occur during regular business operations.

Accurately estimating and effectively managing M&A-related IT costs involves foresight, planning, and collaboration, as various factors can increase the complexity of the process:

- **Early, locked-in estimate.** IT executives are expected to provide an estimate for one-time costs at the inception of an M&A deal. Once they put that estimate on the table, they are typically locked in and expected to manage IT costs to remain within their initial estimate for the duration of the transaction. It is important, therefore, that IT executives have strong processes and methodologies in place to quickly create realistic cost estimates.
- **High cost, high visibility.** IT typically has a high cost to integrate or separate relative to other functions. Restatements are highly visible to company leadership and, oftentimes, to company auditors and Wall Street. Cost overruns may require that funding be appropriated from other essential programs or that IT absorb the overages in its operational budget.
- **Long integration time.** IT is typically the longest pole in the tent; in addition to usually having the highest cost to execute, the function often takes the longest time to integrate or separate (generally a number of months or years, depending on the size and complexity of the systems involved). Oftentimes, personnel in non-tech areas (e.g., sales, marketing, HR, and procurement) have completed their function-specific deal execution and moved on to their new roles while IT remains stuck in the throes of the recently concluded M&A event. IT's long M&A execution timeline can blur the line between a restructuring charge and business as usual (BAU) expense.

These factors can place considerable pressure on IT executives to get an M&A-related one-time cost estimate right the first time and do it with forethought and precision. This article suggests leading practices to help IT executives accomplish these objectives.

#### Estimating one-time IT costs

Each M&A transaction is unique, so an IT cost estimate

should be right-sized for the specific circumstances related to the current transaction. Among leading practices to consider:

- **Meet in the middle.** This alignment process typically begins with estimating one-time IT costs by performing two types of analysis: top-down and bottom-up. The realistic estimate is often somewhere in the middle. Top-down analysis is typically performed by identifying cost benchmarks based on similar transactions, expressed as a percentage of the current operating budget. Transactions are like fingerprints: each is unique and so is the cost estimate needed to finance the transaction. So, while benchmarks may not be totally accurate, they can provide a basis for comparison. Existing cost allocations may also be used to help understand the run-rate impacts of separation.

To help offset the common limitations of top-down analysis, companies should also consider conducting a bottom-up estimating exercise with the IT management team. This exercise may be restricted by the confidentiality requirements of the deal that could, in turn, generate questions and confusion; however, to the extent it is practically possible, the entity management should consider bringing the primary IT management team "under the tent" to aide in the alignment on overall assumptions and generate estimates. This helps increase ownership for these estimates when managing to them. The final estimate could be expressed as a best/worst case, considering both the top-down and bottom-up estimates. These estimates would be bolstered by assumptions that are consistently reviewed and reassessed during execution of the M&A event.

- **"Bite size" it.** It is critical to maintain focus on key components when estimating one-time IT costs; these typically include capex, opex, hardware, software, and labor. The components should be further decomposed into views such as "by geography" and "by time" to better understand the levers in transaction costs. Given that the size of the IT cost bucket is often significant, it is subjected to external scrutiny; therefore, it is important that cost category definitions are confirmed with the company's CFO and auditors to help minimize future reclassifications between capEx and opex. For example, should contract project managers and programmers be classified as capex or opex? Should a license discovery tool that was procured during the transaction but is

expected to be leveraged by only one of the companies after execution be called capex or opex? Classifications are also important in defining which transaction costs can be considered as restructuring costs to be reported to Wall Street and other external parties, and which costs can continue to hit the operating budget.

- **Don't forget.** M&A transactions, especially separations, include specific costs such as stranded costs and IT Transition Services Agreements (TSA) costs. In a separation, stranded costs are the fixed components of costs that stay with the remaining entity (RemainCo) despite the decrease in the number of users. Prime examples are excess hardware, network services, and fixed or semi-variable license fees. These costs typically comprise five to fifteen percent of major contracts.

IT TSA costs are costs that RemainCo will typically incur to provide temporary IT services to the divested entity (SpinCo) after legal separation. In contrast, reverse TSA costs are the costs that SpinCo will typically incur to provide temporary IT services to RemainCo after legal separation. An example is when SpinCo needs to continue using RemainCo's ERP platform after legal separation. The IT infrastructure, software, and labor costs to maintain the service for SpinCo users, as well as the eventual costs of separating the platform, should be taken into account. These costs may vary and estimates should be based on input from the IT management team.

Also, it is important to include a buffer for unexpected expenses that may emerge during deal execution. These can be anywhere between five and fifteen percent of the final estimate. As well, a best practice is to document all assumptions involved in the estimating process, revisit them frequently, and highlight changes over the course of the transaction.

To illustrate these leading practices, we highlight the experience of a Deloitte client, "ParentCo," which recently transacted a separation. ParentCo separated into two equal halves—RemainCo and SpinCo—to focus on the core competency of each entity. RemainCo retained most of the IT assets and SpinCo had to build its IT infrastructure from scratch to cater to the new organization's specific needs. To create an estimate for separation, ParentCo leveraged benchmarks from similar companies that had undergone separation and factored in costs specific to its situation,

such as the stand-up of an all-new IT infrastructure. The company estimated its one-time IT separation costs as 1X its current operating budget based on consideration of the specific circumstances related to their separation. ParentCo established targets for the components of its IT separation costs and divided them into three equal buckets—hardware, software, and labor. It further broke down these costs as capex and opex, with input from its accounting group and primary members of its management team. The process and eventual estimate were vetted with appropriate ParentCo executives, including the CEO and CFO. This process established accountability among stakeholder groups for crafting the final IT separation estimate.

### Managing one-time IT costs

M&A-related, one-time IT costs not only need to be accurately estimated, they need to be effectively managed to help minimize unexpected or stranded costs that may carry over post-transaction. Among leading practices to consider:

- **Realize M&A is different.** Existing cost management processes used during normal business operations typically do not work for managing costs incurred during an M&A transaction. This is primarily due to the quick turnaround involved in monitoring costs during the transaction execution. For example, most IT service vendors do not issue purchase orders (POs); rather, they invoice their client one to two months after rendering their services. Once the company receives an invoice, it generally takes between two and three months to pay the invoice, based on the contract terms. By the time the company records payment against an IT service delivered, often three to five months have passed and this may not be a luxury that a company can afford when trying to manage its IT costs mid-deal.

In cases where companies use forecasting tools to manage their normal IT operating costs, they do not typically track costs to the granular level needed for managing M&A transaction costs. For example, forecasting tools usually only track the total monthly cost expected for a service contract, not the per-resource details that often become important during a transaction. To help circumvent such delays, companies should supplement their existing cost management processes that involve ERP systems with manual processes that match forecasts against commitments against actuals. Tracking this life cycle manually can provide crucial flexibility and responsiveness.

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The finance department is often an integral part of implementing and monitoring costs during an M&A transaction, so involving finance and other stakeholders when developing an interim tracking process can be important. Also note that ERP systems tend to be a vital part of the cost management process; companies should consider establishing cost codes against each work stream that is incurring costs and track actuals in the cost management process.

- **Trust, verify, refine, and repeat.** Once a cost management process is rolled out to the IT management team, the company's top executives should advocate the importance of adhering to a verifiable cycle of forecasting and refining. Cost management should become a critical discussion point in executive meetings to help maintain accountability and accuracy. The IT management team should own its forecasts, commitments, and actuals. A recurring assessment by the CIO and steering committee should occur, in which they ask for historical comparisons against the project run rates to validate the cost data and the assumptions on which they were based. Forecast variances should be managed through change requests that are reviewed on a regular basis, such as weekly. Budgets should be refined based on forecast probability estimates. Any known buffers should be visible and reserves watched carefully. Reserves should be compared against the effort depicted in the project plan and the resource plans that would be used to separate them. This is typically the point in the M&A timeline where the process starts to unravel if good planning is not supported by good follow-through; ongoing executive oversight can help move the process forward as designed.
- **Connect the dots.** IT cost management is only as effective as the project implementation plan that supports it. It is important for IT executives to connect

the dots and develop the separation project plan using detailed and realistic cost estimates. The plan should be loaded and leveled to understand the types of resources involved and the utilization of each resource. For example, labor estimates should be based on the duration as well as the effort involved in plan execution. Any change in the project plan should be validated against changes in associated costs. Similarly, changes in the transaction strategy should be aligned with changes in the project schedule and costs.

In addition to connecting the dots at the project level, IT executives should connect the dots for their fellow executives by consistently communicating progress on the execution roadmap and in executive forums. Any cross-functional implications or support should be called out to help minimize surprises in later stages of transaction execution.

Realistically, most of the estimating and managing process has to be done manually as existing automated budgeting and cost processes are often not granular enough for purposes of budgeting and tracking costs related to an M&A transaction. Therefore, it is critical to identify a team of detailed-oriented resources and strategic resources who can visualize and manage the process from cradle to grave.

Continuing our case study from above, ParentCo implemented a manual process to collect the forecast and commitments from the various sources of input. Actuals were provided by the ERP system, which were mapped against the same cost elements used in the manual tracker. Budget buffers were clearly called out. The CIO validated changes to the cost estimates using change requests on a weekly basis and compared actuals and commitments against forecast on a monthly basis. The IT management team was asked to explain variances and refine estimates regularly.



### Conclusion

One-time IT cost estimating and management is vital to the effective implementation of an M&A transaction. IT executives should understand the implications of accurately estimating and effectively managing these costs and bring their team and fellow functional executives with them on the journey to completion.

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## M&A technology contract separation: Stay strategic

Part of the *#Tech @the heart of M&A* series on M&A technology topics

Contract separation is a critical part of an M&A carve-out transaction, be it a divestiture, asset sale, or spin-off. Information Technology (IT) contracts are among the largest, most costly, and most complex contracts to separate because they can encompass both software licenses and physical assets such as servers and telecom equipment. Without sufficient preparation and a strategic approach to technology contract separation, both seller and buyer run the risk of incurring significant costs and violating contractual agreements. Sellers may not realize that vendor permission is almost always required to allow the carve-out unit to continue using established vendor contracts after the transaction closes. Buyers, in turn, may incorrectly rely on the seller to separate the contracts sufficiently to allow the carve-out unit to operate in the near term and long term.

the vendor that benefits all parties. Following these suggested steps can help M&A participants execute an effective and strategic technology contract separation.

### 1. Identify vendors and define requirements

The first step to executing a contract separation is identifying the vendors and associated products and services that are applicable to the carve-out unit. This typically requires a top-down and bottom-up effort:

- *Top-down*—The centralized procurement team queries vendor spend databases or manual data repositories to identify a list of vendors/products applicable to the carve-out.
- *Bottom-up*—Business and functional-level subject matter experts develop a business-critical vendor list.

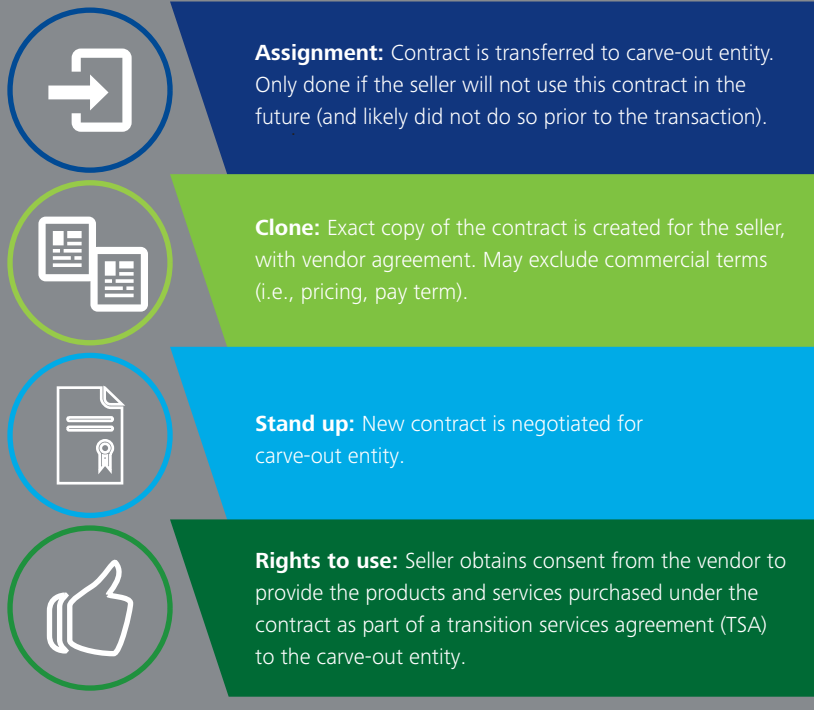
The next step is determining whether the carve out will continue to require the vendor/product after the M&A deal closes—also referred to as defining the business intent. Often, defining the business intent can be a challenge, as the buyer’s decision makers may not yet be engaged or choices about the target state are farther down the planning path and have not yet been made. At this point, an effective practice is to compose a set of broad assumptions and obtain alignment from senior executives on both sides of the transaction.

### 2. Obtain the contract documentation

It is common for companies to underestimate the effort needed to locate all contract documents, especially during the time crunch of an M&A transaction. In a best-case scenario, the seller uses a contract management system that contains the majority of contracts. In a worst-case scenario, no such centralized solution exists and contracts are dispersed across geographies on shared server drives, in file cabinets, and on employee hard drives. It is essential to search for contracts as early as possible in the M&A process. Also, companies and their technology and procurement teams can cast the net broadly, even if the M&A team has not yet confirmed whether a specific contract is relevant or required. One important category to remember is contracts purchased from technology resellers. In this case, the company may need to request a data inventory of all purchase contracts from the reseller and then reclassify this information by each original vendor.

Once contracts are located, they should be stored in a centralized, secure repository and catalogued in a contracts database that is developed specifically for the M&A transaction.

#### Contract separation: Frequently used terms



#### What should M&A participants do to prepare for contract separation?

Although most of the responsibility and work in a technology contract separation typically falls to the seller, there is benefit for the buyer to monitor and/or participate in the process and urge the seller, if necessary, to structure an agreement with



### 3. Reach agreement with strategic vendors

Specific vendors and the associated contracts may be considered critical to the carve-out entity and are labeled as strategic because of their:

- *Financial impact*—Vendor has a material component of the carve-out's cost base
- *Level of criticality to operations*—Vendor products/services are customer-facing or integrated into core processing
- *Complexity of transactions*—Vendor arrangement with the seller includes a number of ongoing, complex purchasing arrangements

Working with strategic vendors (see figure 1) on contract separation is likely to take significantly longer than for other contracts. In fact, the rule of thumb is that strategic vendors are “the first and the last ones you talk to.” Reaching an agreement with certain strategic vendors is generally a requirement for the seller; it may be incorporated into the sales agreement governing the transaction or listed as a dependency for deal closing. It is not uncommon for a buyer to insist on the seller being responsible for costs associated with their “rights to use” the software during the transition period and to cap the potential cost for the buyer's continued use of the agreement.

**Figure 1: Working with strategic vendors**



### 4. Budget for one-time and ongoing contract separation costs

One-time contract separation costs—consent fees or repurchasing costs—are an often overlooked component of an M&A transaction budget. The objective of contract

separation is to minimize one-time costs; however, it is important for seller and buyer to agree on which party will be responsible for the costs before and after deal close.

In addition, the seller and buyer may incur ongoing costs driven by contract separation. The seller may be left with stranded costs for products and services that were previously borne by the carve-out but are not transferred as part of the transaction. In this case, the seller may incur costs for more licenses than are actually required for the remaining business. The buyer, in turn, may have to repurchase licenses. Additionally, both seller and buyer may be subject to pricing increases if the original contract pricing included volume-based discounts. To prepare for worst-case scenarios, a high-level cost estimate should be included in the transaction budget to cover for these potential cost overruns.

### 5. Understand the potential risks

IT vendors are aware that changing software and hardware solutions can take extensive time and effort, both of which are at a premium during an M&A transaction. Some vendors will try to hold companies “hostage” and not agree to a contract assignment or a clone without a one-time payment, a rate increase, or both. Discussions with certain vendors may extend until the buyer is unable to seek an alternative solution and is left with little negotiating power. Vendors are even less inclined to be agreeable if they know that the buyer purchases the same product or service from a different vendor and, therefore, there is little likelihood for a longer-term relationship.

### 6. Select and execute the contract separation approach

Most contracts, including software license agreements and data subscriptions, restrict use to the original licensee and its affiliates. Therefore, the first priority when designing and executing a contract separation approach is to determine that the carve-out entity has a contract to operate on Day 1. The second priority is to minimize one-time and ongoing costs to the seller and the carve-out business unit.

A traditional contract separation approach might include the following components:

- Conduct legal review of contracts and record attributes
- Assign contracts wherever possible; otherwise, negotiate transfer terms and fees
- Repurchase licenses and negotiate new contracts, where transfer is not allowed

This approach can be time-consuming, costly, and present risks to meeting the Day 1 timeline. It opens the door for vendors to start contract negotiations—driving increased one-time transfer costs and ongoing stranded costs to the seller. Additionally, it may overlook the need to obtain necessary “rights to use” permission to authorize transition services agreements between seller and buyer.

Deloitte’s approach helps enable Day 1 business readiness and mitigates compliance risk. The primary components of this approach (which can be customized to meet each transaction’s specific requirements) are:

- a. Establish vendor communication strategy
- b. Obtain “rights to use” for transition period
- c. Clone (i.e., duplicate) contracts for the carve-out entity
- d. Gain approval for license transfers

This approach frames M&A-driven contract separation as a business event rather than a negotiation. By doing so, it seeks to limit/reduce one-time transfer costs and mitigates for both seller and buyer cost increases resulting from license repurchases or stranded costs. No detailed review of contract terms is required, as this approach is founded on the assumption that both short-term and long-term rights are required by the carve-out. Re-contracting also reduces the need for detailed up-front analysis and reduces concerns that the future intent is not yet known by the business and functional experts. Re-contracting also benefits vendors, as it provides a reason for the carve-out to remain a customer rather than seek an alternative product or service provider. Additional business is likely to follow, as two separate companies will require technology solutions to maintain and grow each business.

Technology assets are worth millions of dollars; protecting that value during and after an M&A transaction should be a primary goal for all parties. By working proactively, fostering a collaborative approach, and treating M&A-driven contract separation as a business event rather than a standard negotiation, seller, buyer, and vendors can craft a re-contracting agreement that’s a win-win-win.

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## Making a “poison pill” easier to swallow: How to manage M&A-related software licensing costs and compliance risks

Part of the *#Tech @the heart of M&A* series  
on M&A technology topics

CIOs who use a centralized, streamlined approach to M&A-related software license re-contracting may reduce costs, aid compliance, and enhance the value of the entity in play.

With M&A activity on an upward trajectory, CIOs of companies undertaking mergers, acquisitions, divestitures, and joint ventures may be facing millions of dollars of unanticipated software expenses—temporary and long-term licenses, transition services, and other third-party agreements—that often are unaccounted for in deal terms.

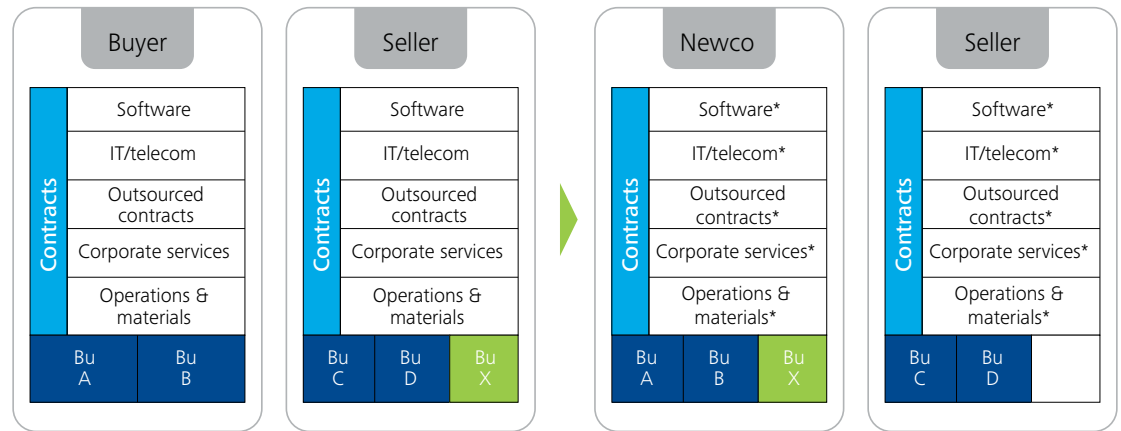
CIOs can make this “poison pill” easier to swallow by using a centralized, streamlined approach to M&A-related software license re-contracting. Doing so may help to reduce costs, aid compliance, enhance the value of the entity in play, and raise awareness of the IT organization’s value at the highest levels within the company.

During a recent divestiture of a Fortune 200 diversified energy company, centralizing and streamlining IT contract separation resulted in cost avoidance of approximately \$50 million through license transfers and negotiated savings.

**The need for IT re-contracting**

A number of factors differentiate the rights associated with software and, to some extent, hardware purchases from other assets a company buys. Software license agreements contain legal protections for intellectual property (IP) that restrict how and by whom the software can be used. Additionally, software licenses are bought but never “owned” and this distinction can be a costly challenge to conducting business as usual on the day a company sells or acquires another entity (“Day 1”) (see figure 1).

**Figure 1: Day 1 IT contract needs**



\*need to be right-sized (capacity, synergy)

**Key takeaways**

- Buyer plus the newly acquired business unit (NewCo) will need additional capacity
- The acquired Business Unit (BU) will require its current licenses, at least temporarily
- The seller will have surplus capacity and stranded costs

A typical business relies upon hundreds, if not thousands, of IT contracts to support systems and applications used across the company. These contracts lock in millions of dollars of assets and restrict their use to only the licensee and their affiliates. As a company evolves and restructures through M&A, the portability of licenses to move with users should not be assumed; license restrictions can make what many thought were assets of the organization worthless in certain situations. Therefore, effective on Day 1, a company that sells or acquires another entity needs to obtain rights to the licenses that support day-to-day operations. Table 1 describes the challenges of following a traditional path to renegotiating these contracts in order to support the M&A event.

While IT integration as a whole is nearly always a key focus area leading up to and continuing for a year or more following a deal’s close, re-contracting software agreements is often an afterthought and can result in substantial, unexpected expenses—sometimes totaling in the tens of millions of dollars—in the form of legal fees, right-to-use fees, software repurchases and, in the worst cases, fees and penalties for noncompliance, as indicated in figure 2.

Table 1


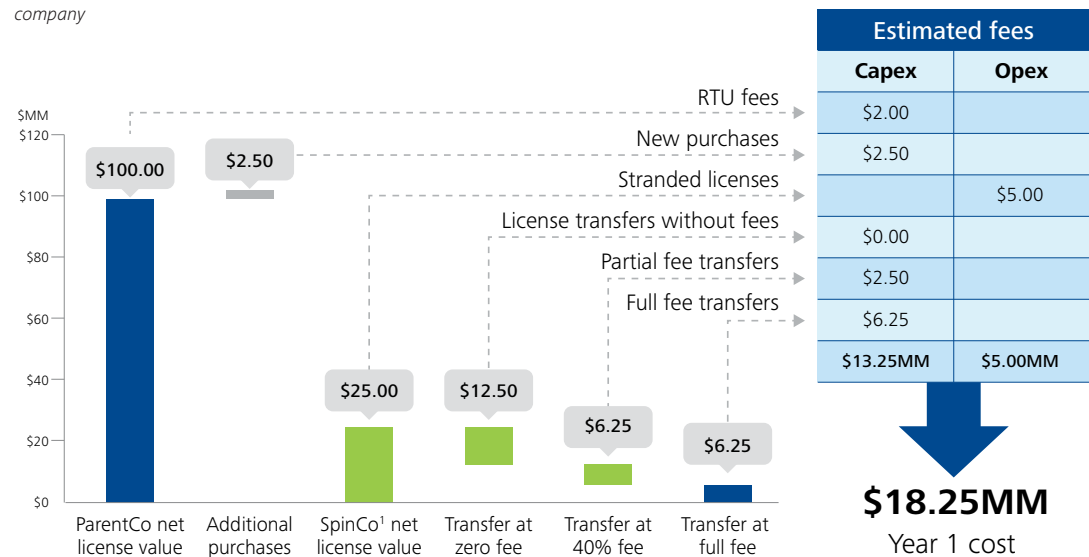
 Compliance	IP protections introduce the risk of noncompliance and significant costs to maintain compliance to any M&A deal.
 Timeliness	The need for IT agreements following an M&A event is essential and the time required to establish these agreements can be substantial.
 Unique knowledge	The nuances of IT agreements require special knowledge of IP restrictions combined with an understanding of the technical requirements.

Figure 2: Traditional approach to contract separation may result in substantial fees (illustrative)

For a company that spends ~\$20MM on software maintenance, the cost is estimated to be more than \$18MM for license rights to divest 25% of company

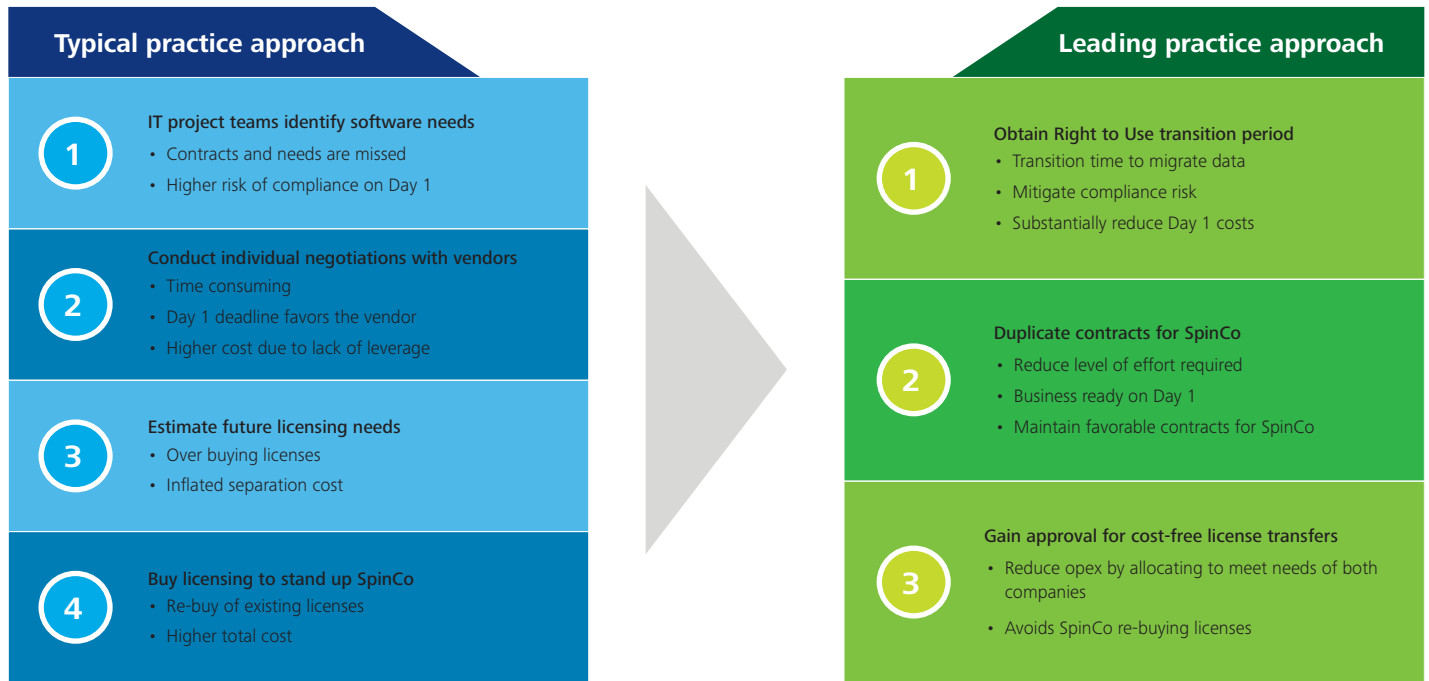


<sup>1</sup> SpinCo is the divested entity

The traditional approach to software re-contracting (see figure 3) relies heavily upon the involvement of corporate or outside legal staff, the corporate procurement department (which may not understand the nuances of IT agreements), or individual users (who likely lack an enterprise-level perspective). When a deal is announced, the buyer’s legal representatives typically process on a piecemeal basis what can be a flood of re-contract requests in an effort to stem compliance concerns. Meanwhile, the purchasing department or individual users contact vendors to obtain additional licensing to support the divested or acquired entity on Day 1. This one-off-based approach often produces a host of unexpected, noncompliant situations due to the backlog of agreements still waiting for legal approval on Day 1. It also results in the divested entity incurring higher-than-forecasted license costs. The seller, in turn, may find that it retains responsibility for maintenance payments for licenses stranded in the department that previously supported the divested entity but did not go with the sale. Ultimately, the seller faces a stranded cost implication.

In contrast, CIOs who use a leading practice approach centralize all deal-related license re-contracting issues to better control costs and reasonably make certain that on Day 1, all parties have access to the software they need while reducing stranded costs across the ecosystem. These CIOs enhance their value to the organization by reducing licensing fees, shortening costly and cumbersome Transition Services Agreement (TSA) periods, and using the visibility afforded by an M&A event to improve licensing costs across the entire organization. Importantly, CIOs understand that this approach requires total alignment of the executive leadership team, highly governed project management to meet Day 1 requirements (e.g., establishing governance, gathering data and reviewing contracts, defining strategies, and negotiating mutually beneficial agreements), and partnering with vendors to make the separation process beneficial for both parties while maintaining the useful value contained within existing licenses.

Figure 3: Typical versus leading practice approach



To begin contract separation, the seller and/or buyer should dedicate resources to a centralized contracts management office that is completely focused on contract separation activities, controlling outward communication, and reducing the need for legal involvement by using a standard amendment to leverage existing contracts for the new entity wherever possible. This approach shifts the re-contracting effort from legal staff, allowing them to focus on myriad other deal-related requests. In addition, leveraging the agreements currently in place for a divested entity (particularly if they were for a larger enterprise) reduces the quantity of new software and other IT agreements required prior to Day 1. This lessens the procurement burden, bolsters the buying power of the combined organization, and quickly positions the new entity for success. Following

Using the leading practice approach, a Fortune 200 diversified energy company divesting a significant portion of its organization saved nearly 90 percent in estimated separation license costs.

the divestiture or acquisition, a full assessment of the IT portfolio, preferably via an automated process utilizing scripts, allows the contracts team to identify potential software for transfer and other areas where licensing support costs could be reduced, as well as to renegotiate or source new agreements where business needs have increased. Using these techniques, companies have realized significant reductions in software costs, as illustrated in figure 4.

**Figure 4: Using the contract separation process may avoid significant costs (illustrative)**

*A structured approach can reduce 80% or more of IT license cost associated with divestitures*



**Strengthening the vendor-client relationship**

Although a centralized contracts team is likely to work more efficiently using a “war room” approach—requesting a standard set of terms from vendors—it is important to work directly with vendors that have high-value agreements or particularly impactful relationships with the organization. Because of its annual maintenance payment structure, key IT vendor-customer relationships should be viewed as a partnership: In return for consistent revenue, the vendor provides support and services for all contracted products. Offering a customer flexible solutions during a time of transition adds value to this relationship, thereby enhancing the vendor in the customer’s eyes, earning it a place in the IT portfolio for both the divesting and divested entity and strengthening the vendor-client relationship in the near and long term.

**Benefits of a centralized approach**

The effort, time, and cost required to maintain software continuity through a merger, acquisition, or divestiture can be substantial; however, the impacts of mismanaging the re-contracting effort may be much worse—risks of noncompliance, penalties, transfer fees, and duplicate licensing, among others. Although the re-contracting period prior to Day 1 is not ideal for making wholesale changes to the goods or services under contract, it is an opportune time to leverage existing volumes and contracts for the new entity and determine those that are no longer needed in the post-deal world. Taking a centralized approach to software re-contracting may generate considerable benefits (see table 2).

Table 2

 <p>Partnership</p>	<p>A coordinated process with vendors as partners, rather than adversaries, can help reduce expenses.</p>
 <p>Leverage</p>	<p>Existing agreements can be leveraged for new entities to reduce legal commitment, expense, and speed to contract.</p>
 <p>Cost improvement</p>	<p>IT leaders can use the visibility and appetite for change afforded by an M&amp;A event to more broadly examine license deployments and improve costs to the organization.</p>
 <p>Asset management</p>	<p>A well-executed M&amp;A re-contracting process provides visibility into IT assets and their significant value.</p>

By managing M&A-related software licensing costs and compliance risks more effectively, CIOs and the IT organizations they lead can exit a deal with an improved cost structure, a better understanding and command of the assets they control, strengthened vendor relationships, and the ability to better satisfy the needs of their internal and external constituents.



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