Chief Executive | elliott davis

Maximizing M&A Value: A guide to evaluating IT's underlying risks and assets

Technology has become central to all business operations today. Lack of adaptability in systems and processes, just like dated technology and skills gaps, can be costly for companies trying to compete with the high rate of disruption across industries.

It's a best M&A practice that when looking to acquire, sell or divest, companies place technology—from networks and systems to talent and IP—at the top of the due diligence checklist. Doing so ensures buyers know what they're getting, and sellers get a fair price for their work keeping up with advancements.

Yet, a recent survey from *Chief Executive,* conducted in partnership with Elliott Davis, finds technology remains one of the most undervalued aspects in M&A transactions. Only 9 percent of the 200 CEOs surveyed in early December 2022 said a target's tech capabilities is a critical driver of M&A, and 21 percent said technology had little to do with M&A activity today.

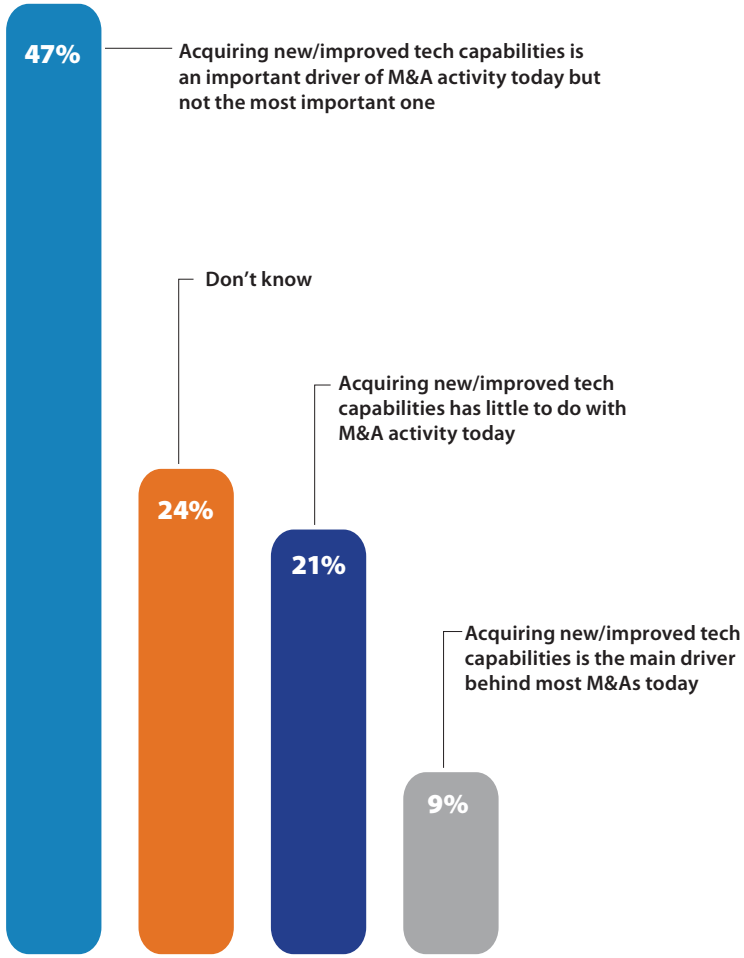
Instead, the survey shows that the acquisition of technology assets—a critical component of any modern company—ranked at the bottom of the list of factors influencing M&A decisions, behind top-line growth, revenue or operational synergies, accessing new markets and the acquisition of skills/talent, in that order.

There's no doubt top-line growth should be a primary motivator for any M&A, but technology is a factor that can also turn a seemingly good "revenue" deal into a failed transaction. Take, for instance, the recent case of a medical practice that was looking for investors. The practice had no policies or procedures, IT or otherwise. Employees were allowed to use personal computers that were not centrally managed, and it was discovered that critical patient data was kept on the receptionist's computer. This led to a deeper discovery of how careless the practice had become at protecting patient information and presented such a noticeable risk that the investors passed on the deal.

Technology is a critical driver of growth today, and relegating it to an after-thought and an aspect that is too often dealt with post-deal is a significant missed opportunity. After all, acquiring a company for its knowledge and capabilities is a strategic way to grow the business quickly, particularly in today's labor market and highly disruptive environment.

With the role of technology being so central to operating a business, acting on a deal that promises good financials without taking a deep dive into the technology that is being acquired first can lead to unintended and costly consequences.

In your view, what role does technology (infrastructure, systems, cybersecurity, talent, etc.) play in driving M&A in the market today?



Failing to give sufficient consideration to IT in the initial stages of a potential deal carries significant risk, including:

- **Inheriting technical debt.** Aged IT infrastructure increases the potential need for large post-close IT investment as well as the risk of business-critical systems being unsupported/unstable.
- **Increased risk/exposure of sensitive data/information**. A brief cyber review of the controls and security processes in place should be done to mitigate risk. This is especially true in the healthcare and financial sectors, where there is intense scrutiny on the protection of sensitive and personal data.
- **Inability to scale.** Dated or improperly sized IT systems can prevent an organization from scaling up or growing quickly. The business goals should be outlined, and a review of people, process and technology should be documented to support those goals.
- **Inaccuracy of information**. An essential part of a pre-close assessment is truly understanding the target's business model and performance. Risk increases if the target does not have quality financial and business performance reporting. This includes top-line revenue, COGS, margin, product mix, marketing mix effectiveness, labor statistics and business drivers.

IT Due Diligence: Why, What, When

Most CEOs surveyed reported not having a thorough understanding of their company's technology components or the tech gaps or limitations they need to be monitoring when bringing in another entity. When asked to rate their understanding of various IT components at their organization (e.g., cyber vulnerabilities, IP rights and limitations, systems integrability, applications transferability, regulatory compliance, and data storage and quality), surveyed CEOs ranked their understanding somewhere in the middle of our 5-point scale—not poor but not thorough either.

For those seeking to sell the business (or parts of it), the primary goal should be preparing the technology to pass the due diligence test, which requires thorough understanding of the health of every one of those components and what that may mean for a buyer.

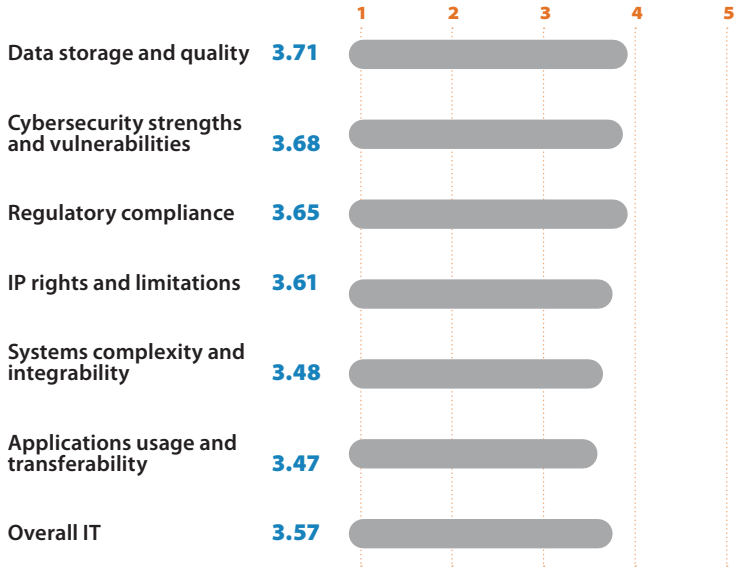
For buyers, the rule of thumb is the fewer questions you ask upfront, the more risk you assume, which makes conducting an assessment into the technology early on a vital part of the process.

Top Reasons for M&As in 2023

1. TOP-LINE GROWTH
2. REVENUE OR OPERATIONAL SYNERGIES
3. ACCESSING NEW MARKETS
4. ACQUISITION OF SKILLS/TALENT
5. ACQUISITION OF TECHNOLOGY

CEO Ratings of Their Understanding of Their Company's Technology Landscape

(5-point scale, where 1 is Poor and 5 is Thorough)



Before making a sizable acquisition, most companies will conduct a quality of earnings check to make sure the financials are accurate from a top line and EBITDA perspective. Technology, because it is the backbone of how the company will operate, should be included in this core due diligence process. On one hand, it helps validate the financials and on the other, it allows the buyer to know if the company can be scaled for growth—which is ultimately the goal for most companies.

When looking at the target's technology, it's critical to understand not only what you're buying into but also what you need, what you're acquiring, what gaps the new entity fills in your own environment, and how compatible or how well it can be integrated. Some of the questions to ask include:

- **Will it add value to our existing infrastructure, or will it create conflicts or redundancies?**
- **Can systems be integrated without creating silos?**
- **What efficiencies will we gain and in which areas of the business?**
- **What else will we need to acquire or access to complete the bigger picture?**

Conducting due diligence of the target is important, as is understanding how what you're buying will support the company's goals. Larger companies are more likely to incorporate an IT due diligence into their M&A process, but smaller companies, often in an attempt to mitigate costs, tend to go into a deal thinking they can overhaul the technology later on. The problem with that is the overhaul—the cost to "rip and replace"—is usually much higher than baking the technology assessment into the process up front.

For sellers, proactively conducting an IT or cybersecurity assessment of their company can help speed up the deal and secure a better premium by making a case for why the acquisition can support the buyer's goals. The more proactive a seller in providing details about the company's IT components, the smoother the deal is likely to be.

In the end, every part of this process, whether it's done up front or post-deal, by the buyer or the seller, will affect the purchase price, and the overall cost of the transaction. But the problem with the post-deal approach is that the cost can escalate exponentially. For instance, an acquiring company may buy into an IT situation that carries the risk of penalties, fees or even legal proceedings. For sellers, this may mean getting a reduced price for your business because of failure to demonstrate the value of your infrastructure, thus requiring the buyer to conduct further assessments.

To help in the process, consider some of the key questions and actions below, and remember that the earlier on in the process these are tackled, the lower the risk of a deal falling through because of technology.

BUYERS' QUESTIONS:

1. Has the company experienced a breach previously, what are the details surrounding the event and what remediation and prevention steps were put into place because of the event?

2. Can the company provide an accurate inventory of their technology stack (hardware, software, licensing, etc.)?

3. Has the company ever performed an IT or cybersecurity assessment? What were the results, and can the company provide a copy of the report?

4. Has the company ever conducted compliance assessments (HIPAA, PCI, CCPA, etc.)?

5. What percentage of revenue is spent for technology initiatives?

SELLERS' ACTIONS:

1. Gather and proactively provide proper documentation for all aspects of the IT environment (org charts, contracts, inventories, disaster recovery, incident response, business continuity, etc.).

2. Perform a vulnerability scan to ensure the infrastructure is secure and being properly maintained—and provide a copy of the certificate.

3. Conduct an IT or cybersecurity assessment and provide the results to the buyer.

4. Identify all technological frameworks in how IT services are provided to the organization (ITIL, COBIT, etc.).

5. Determine whether IT is a strategic business enabler or a utility that "keeps the lights on".

ABOUT THE RESEARCH

The survey was conducted online, anonymously, by Chief Executive Group December 6-8, 2022. A total of 199 qualifying U.S. CEOs participated. The participant demographics are illustrated below.

TITLE*

CEO	75%
President	46%
Owner	9%
Founder	8%
Chair	4%
Divisional President	2%
Other	2%

**Respondents were asked to select all that apply.*

COMPANY SIZE

(by annual revenues)

$1 Billion+	3%
$500 Million to $999.9 Million	4%
$250 Million to $499.9 Million	8%
$100 Million to $249.9 Million	16%
$50 Million to $99.9 Million	13%
$25 Million to $49.9 Million	15%
$10 Million to $24.9 Million	23%
<$10 Million	17%

SECTOR REPRESENTATION

Manufacturing (Industrial Goods)	19%
High Tech/Information Technology	9%
Manufacturing (Consumer Goods)	9%
Other	9%
Advertising/Marketing/Media/PR/Entertainment	8%
Financial Services	7%
Professional Services	7%
Construction/Engineering/Mining	4%
Government and Non-Profit	4%
Health Care (Providers and Payers)	4%
Pharmaceuticals, Life Sciences & Medical Products	4%
Wholesale/Distribution	4%
Retail Trade	3%
Transportation	3%
Telecommunications	3%
Real Estate	2%
Travel and Leisure	1%
Energy/Utility	0%

Chief Executive Group

About CEG

Chief Executive Group improves the performance of U.S. CEOs, CFOs and public-company directors, helping them grow their companies, build their communities and strengthen society. Through our membership-based peer networks, live conferences and events, proprietary research and flagship publications–including Chief Executive and Corporate Board Member–we connect the leaders of nearly every sizable company in the United States, enabling them to share experiences, insights and hard-won wisdom to mutually benefit each other.

elliott davis

About Elliott Davis LLC

Elliott Davis is a leading business solutions firm offering a full spectrum of services in the areas of tax, comprehensive assurance, and consulting services to diverse businesses, organizations, and individuals. With a network of more than 750 forward-thinking professionals in major domestic markets and alliance resources across the globe, the organization ranks among the Top 50 and fastest-growing accounting firms in the United States. Elliott Davis has been providing innovative solutions since its founding in 1920.