Disruptive acquisition

Directors and boards are used to navigating post-acquisition IT roadmaps, signing off on piles of cash to standardise information systems and deliver the sought-after cost efficiencies. But too often in the process they stifle the innovative systems and processes of the acquired party, throwing the metaphorical baby out with the bathwater. ***Clare Coulson*** *investigates and finds a new approach is needed to foster and nurture the tech nuggets that are capable of disrupting business and magnifying future success...*

When Google bought digital ad-serving provider DoubleClick for US$3.1 billion back in April 2007, in what was its second largest acquisition of all time, it wasn't because it liked the roses planted in the front garden. Google recognised that DoubleClick's technology would be a critical component in creating AdSense, the engine that serves Google ads onto its partner network sites. The result has been a core revenue engine for Google, generating around US$13 billion in annual income – about 23 percent of Google's total. It's an acquisition that has paid off in spades.

Yes, it's a tech company buying tech capability, but the lesson is that we should look more deeply into acquisitions as opportunities to buy technical or digital capabilities we lack.

A foreign future

As the article '*Man, Machine and the Productivity Story*' on page 14 demonstrates, "the past," as the famous quote from LP Hartley goes, "is a foreign country: they do things differently there". And so it is with the future. It is clear, however, that advances in technology are what will drive and shape that future, and have significant implications for business success.

An economic forecasting model developed by Australia's National Institute of Economic and Industry Research was recently used to predict the difference that technology can make in business. It looked at how organisations that embrace technology early will fare out to 2025, and the extent to which technology followers will lag. It argues that by 2015 most business sectors will have been substantially affected by global digitisation, and those who don't take advantage of the step changes that technology can make will find themselves limping far behind.

For example, if the NIEIR model is applied to a hypothetical 'leader bank' with $15 billion in revenues today, and a 'follower' bank with $12 billion of current revenues, they should expect their revenues to diverge massively to $32 billion and $17 billion respectively in 12 years. Over the same period the market capitalisation of the leader bank would rise to $69 billion, while the valuation of the follower would actually shrink to $22 billion by 2025.

In response to the NIEIR results, Jenifer Westacott, chief executive of the Business Council of Australia, said that boards now needed to challenge their thinking and determine whether they have the technology skills and the imagination to ensure they will be leaders rather than laggards.

David Moss, CIO of Vodafone New Zealand, says "IT is changing rapidly and is the driver for improved efficiency. If you look at every industry the internet is changing the way that we do business, our selling models. We're not talking about incremental change, we are talking about step change – you can reduce your costs in certain areas by 50 to 90 percent. If companies aren't looking at those trends and leveraging them they could find themselves very quickly going out of business."

Vodafone recently purchased fellow Kiwi telecommunications company Telstra Clear and Moss says that IT was at the forefront of the acquisition plans, stemming from the recognition that a great deal of value could be gained by combining Vodafone's mobile business with Telstra Clear's fixed-line business.

Stuck in the mud

Moss says that as a technology-centric company, Vodafone was inherently focused on making sure that technology had a high profile throughout the merger and acquisition, but he recognises this may not be the case in other industries.

Robert Hilliard, Deloitte's managing partner for technology consulting in Australia, says that boards in the A/NZ region are "somewhat undercooked" on average in terms of their level of technology expertise.

"It's generational," he says. "The information technology profession has been rapidly growing over 40 years. If you think about IT in the seventies, eighties and nineties the first priority was back-office systems. And if you look at what boards are composed of, it's largely from the revenue earning functions of businesses. So there can be a sense on many boards that they are comfortable with information technology as an enabler of business [...] and about thinking about the major systems in terms of the back-office enablement and the return that they provide on the investments. Where they get a whole lot less comfortable is where it becomes a lot more complex and you start looking at rapidly transforming technologies that are actually core to the value proposition of the business."

For Damien Tampling, Deloitte partner and M&A advisor, boards need to be looking at technology from a strategic standpoint and asking questions about how merged technology will fulfil their organisation's strategic goals over the coming years.

"The people on the board should be asking if the business has a set of technologies that allows it to compete in the market and that position it adequately for the future," he says.

For him, those people on the board don't need to be IT experts, instead he puts the importance on experience in disruptive technologies to complement other board members who may have a finance or legal background.

"The key is having someone who has had a lot of exposure to the impact of digital disruption. To have gone through true digital disruption in all its glory as an executive or as a board member of another company is highly valuable experience as there is so much to be garnered from how you need to reshape your business, change your costing models and innovate."

> ***"[Boards] need to understand how critical IT is to the revenue earning activities of the target business and assess the gap between the revenue earning potential and the way the technology is enabling that potential today."***
>
> **Robert Hilliard,** managing partner - technology consulting, Deloitte Australia

Mavericks pay off

Virtually every organisation now has its own way of earning money through digital technology and channels. Six years ago, for example, Domino's Pizza saw the big picture and invested heavily in e-commerce, despite only one percent of its orders being online at the time. It is now Australia's number one digital retailer.

"Our Group CEO saw that online was going to be the future so invested millions of dollars. At the time some people thought we were crazy, but we invested ahead of the curve and now it is paying off," explains Andrew Rennie, Domino's Pizza CEO for A/NZ.

Today, the company processes 50 percent of its orders online and it expects that to grow to 80 percent in Australia and New Zealand over the next couple of years. As a result of its investment, Domino's has created its own intellectual property around technology, such as its Pizza Tracker.

Other businesses will have different innovative ways of servicing their customers online, or will find innovative ways to manage their staff and make them more productive.

"In doing this, these organisations have developed intellectual property," says Hilliard. "That intellectual property is a core asset of the organisation that is being acquired and there is a risk that it gets bundled up and blends in with the back-office IT. In fact it needs to be prised apart, because it really is an important part of understanding the value proposition of the acquisition."

If the board doesn't have an understanding of the intellectual property that is potentially tied up in technology, Hilliard says there is a danger that the true value of the acquisition could be missed or, worse, erased by being standardised to fit the acquiring company's current systems and processes.

Life lessons and opportunities

Vodafone's Moss has plenty of experience in this domain and says that both Vodafone and Telstra Clear had learnt a lot from their previous acquisitions.

"The big lesson that we learnt from the iHug acquisition, which was basically taking a small company and essentially disseminating it into a larger organisation, was that in doing that process (putting iHug finance people in the finance department and HR people in the HR department), we actually broke a lot of the fundamental processes which were operating inside iHug at the time, because the formal structure and the way they operated was completely different. So we were very conscious of making sure that that didn't happen [with the Telstra Clear merger]."

This time Vodafone is using the integration as an opportunity to transform its businesses and make a step change, re-working key processes, rather than simply replicating what it already had.

"There are huge amounts of benefit to be gained from simplifying the processes inside our organisation [...] We can offer a far more productive set of systems and processes and

management capabilities for our customers. We are changing our internal model by consolidating our systems, probably in a very similar way to [recent bank merger] ANZ/National did," says Moss.

Auckland Council, which went through a merger and a separation that saw it move from eight separate councils to one central organisation in 2010, is also taking the opportunity to reconsider its technology and processes. CFO, Andrew McKenzie explains how Mike Foley, head of information services, and his strategy team went through an exercise of asking what the future could look like.

"We had a look at the things we were trying to do to make sure that we were really cost effective, that we took complexity and risk out of the business, that we gave people the opportunity to become more customer focused, and that we had a good fit with the services that Councils require."

Foley adds: "This was no standard merger or acquisition because normally you have a primary partner that takes over somebody. This was fair and equal. We picked what we believed to be the best solutions to drive us forward based on scale, longevity and the investment that we had previously from those old legacy councils."

Since going live with its core services in time for day one of the new council, the local government body has promised reduced complexity, improved service quality and improved IT services to the rate payers of Auckland. But at a price tag that various estimates put at up to NZ$500 million it is not something that is coming cheap.

Risks and rewards

"People tend not to do due diligence on things to look at opportunities," says Deloitte's Tampling. "Whoever is looking at it is looking from the risk perspective, but maybe isn't as open- minded to what the opportunities might be there."

While he doesn't believe it is the role of the board to identify opportunities he does question whether board members are sufficiently skilled to ask the C-suite the right questions. "It's a question of looking at the board and asking if we have the right skill sets on the board for this day and age. It's a big question. I think it is more than technology and digital – it's about disruption and it's about change."

Seeing that disruptive element can be as easy as looking at the IT systems from a different standpoint. Typically the board will have a map of all the IT systems – ERP, CRM, financials etc. – against which they make assumptions, but this only paints one, quite limited picture. Opportunities can be identified by changing the viewpoint and seeing a technology map in terms of the customer, staff and supplier experiences and interactions, or as an enterprise value map.

"I think more often than not boards come to the IT due diligence and the IT question and ask, 'is IT going to be a problem or be an obstacle to the transaction?' and that's the missed opportunity here," says Hilliard.

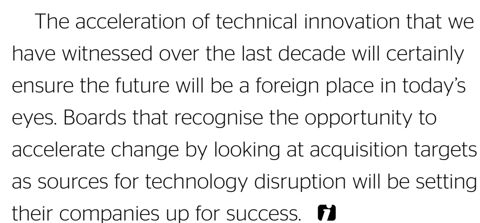
"A board's job is to challenge management and make sure they are asking the right questions and challenging bias. They need to understand how critical IT is to the revenue earning activities of the target business and assess the gap between the revenue earning potential and the way the technology is enabling that potential today."

To the future

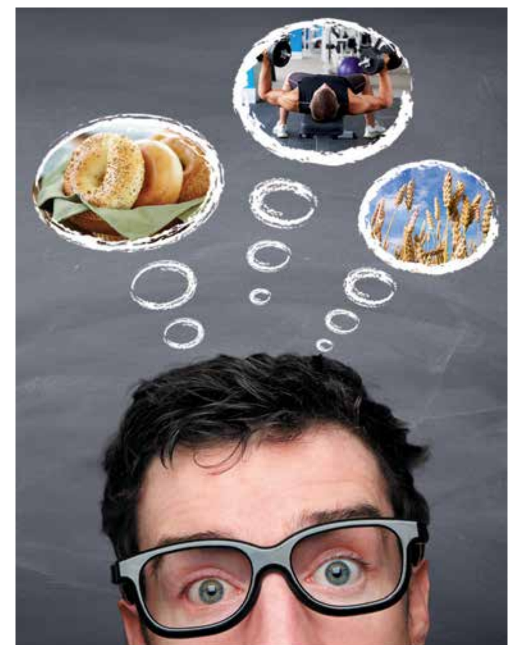
Digital disruption is an inescapable fact. Deloitte itself is preparing for its effects, reportedly seeking to build a $1 billion business through newly-acquired digital capability and reshaping its corporate strategies.

Management is not always so forward thinking. It will show boards technology in terms of what it does today, without understanding that the lifetimes of what it is offering are five, ten and 20 years, says Hilliard. "If you think about what the customer experiences of technology were five, 10, 20 years ago, it was so radically different, it's a reasonable assumption that it's going to be significantly different again," he explains.

As Domino's Rennie says, "You want to avoid investing in yesterday's technology. You've really got to be investing in tomorrow's technology, so don't get caught up in investing in what's hot now you've got to invest in what's hot next year."



The acceleration of technical innovation that we have witnessed over the last decade will certainly ensure the future will be a foreign place in today's eyes. Boards that recognise the opportunity to accelerate change by looking at acquisition targets as sources for technology disruption will be setting their companies up for success.



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