HOW SOFTWARE COMPANIES CAN OPTIMISE A TELECOMS ACQUISITION

Software companies and telecoms companies find themselves confronted with new challenges and opportunities. Covid-19’s impact creates a need for reacting to urgent business threats, such as cash flow and liquidity issues. Accelerating digital transformation and integrating new technologies while ensuring supply chain resilience are other areas most must prioritise. Simultaneously, companies and industries are coming to grips with a slowly emerging ‘new normal,’ which could be rich in opportunities to realise their companies’ full potential – if approached correctly.

BDO has developed the RETHINK model as a framework to help companies navigate what is, in many ways, unchartered territory. We offer companies a full range of financial and advisory services to assist them react to Covid-19, build up resilience and realise their full potential in the wake of the on-going global pandemic. For software and telecoms companies, the way to reach that full potential may lie in joining forces.

For software companies, a telecoms acquisition can lead to many benefits and opportunities inside organisations primed for growth. COVID-19 has increased demand for telecommunication services such as remote working and home entertainment, and expanded the use of broadband services, voice traffic, and video streaming. These changes are causing a shift in telecoms companies’ investment strategies around network reliability and future 5G rollouts.

However, software companies risk seeing increased growth, innovation boosts, access to new customers, and possible business synergies being negated by challenges before, during, and after an acquisition process. Insights about what to expect from an acquisition, how to optimise the acquisition process, and get the results you are hoping for are crucial to avoid such disappointments.

For example, software companies should be aware that they are an increasingly important M&A focal point for telecoms. Increased efficiency for existing services and building out the potential of future services, such as 5G-related offerings, are among the driving factors. Telecoms are also seeing increased competition, especially from technology companies, and a need to diversify product portfolios. Furthermore, Covid-19 creates opportunities for acquisitions of distressed high-quality targets at advantageous rates. Such companies can be integrated into, or combined with, existing divisions and business units or operated as new stand-alone units. Those are some of the reasons why we expect to see a lot of software-related M&A from telecoms in the coming years.

BDO has offices in more than 160 territories and experts advising companies throughout the telecoms and technology sectors, including many software companies. We advise companies in both industries on a wide array of business, audit, and tax-related issues, including mergers and acquisitions. Our industry experts have extensive expertise on how to negotiate and structure deals, as well as practical experience from working in both sectors. They know the thought processes, tactics, and granular details of what it is like to sit on either side of the negotiation table first-hand.

For the full scope of the insights presented in this guide, we recommend that you contact your local BDO office or us to hear more.
These trends are good news for software companies looking at potentially being acquired. Telecoms will want to avoid disruptions and target firms that can help grow technical abilities. Already before Covid-19, telecoms companies were busy looking outside of their traditional sphere of interest, with software one of the preferred spaces for acquisition plays. This includes everyone from smaller telecoms to giants such as Verizon and AT&T.

Telecoms are focused on software companies in a range of sub-industries and seem particularly interested in mid-market and SME companies in the software space. Excellent opportunities for bolt-on acquisitions, augmenting existing services and solutions (mainly through SMEs), and expanding service portfolios (mainly through mid-market acquisitions) are driving factors. Expected increases in IT spending focused on cloud infrastructure is a sign of growing demand, as is also the case for specialised teleconferencing software for remote schooling and work environments. Companies in both spaces will be of interest to telecoms.

Companies that can increase automation, virtualisation and intelligence throughout telecoms’ networks are of particular interest. Their prevalence on telecoms’ wish list is partly connected with a strategic focus on trying to take advantage of business opportunities tied to the networked economy, which has received even more attention in the wake of Covid-19 due to demands for accelerating digital transformation.

Other particularly prominent target segments include companies that have brought complementary or competing products or solutions to market faster than telecoms and companies whose solutions enable reaching strategic goals. Telecoms continue to push for the so-called ‘quad-play’ services, where broadband internet, television, wireless, and landline phones are offered to customers as bundled deals. However, quad-play is for many being replaced by ‘x-play’ as telecoms look across other adjacent industries, such as technology, media, and entertainment, to capture growth opportunities.

Big data and data analytics are other areas of great interest to telecoms that have vast stores of customer data but have struggled to leverage it for business insights and new services. Finally, telecoms are betting heavily on new 5G networks and related services and will be looking with great interest at targets that enable them to speed up development and deployment further.
Understanding why your capabilities are of strategic and tactical value to the telecoms company also forms part of the foundation of setting realistic targets for the negotiation process. The first step is finding answers to questions like how your products or services can solve telecoms' current challenges and realise their long-term goals. That, in turn, requires knowing what changes Covid-19 may have meant for short- and long-term strategies in the telecoms industry.

The Internet of Things, AI, robotics, smart cities, and driverless cars are all likely going to rely heavily on high-speed networks provided by telecoms. Even before the global pandemic, telecoms were also aiming to be much more than ‘just’ providers of communication infrastructure, pursuing growth and new revenue streams across adjacent industries.

Defining how your services and solutions fit within that framework and augment a telecom’s current portfolio will help make your company as appealing as possible and provides valuable arguments for the negotiation process.

While it may sound simple, a clearly defined value proposition includes analysis of many different business areas. Your current services and products, ongoing R&D, legal situation, intellectual property rights, employee contracts, potential claims and liabilities, third-party reliance for services, cash-flow, warranties, compliance, and tax issues are just part of this non-exhaustive list. Furthermore, each list section has many sub-parts.

Your value calculation should also include projections of future earnings and growth potential, and what synergies, efficiencies, and new opportunities your services and solutions create for your acquirer. A good yardstick to help determine your company’s worth is looking at previous similar deals. However, it is essential to note that each negotiation process and situation is different. This is doubly true for the current situation where generating accurate valuations, which are often based on future projections, has become very challenging.

Identifying your value proposition and setting a realistic target may require outside assistance. Allying yourself with M&A and industry experts will also increase your ability to discern telecoms’ negotiation tactics from real areas of concern.
The list of potential benefits is long. Telecoms can offer access to a vast organisational and contact network, in-house expertise, and more. Many software companies considering potential acquisitions are looking for ways to take their company—or solutions—to the next level. In such a case, telecoms provide an excellent alternative to traditional funding alternatives like VCs. Telecoms can, for example, sometimes value ongoing R&D over short-term profitability targets.

If your solutions or services are customer-facing, access to telecoms companies’ substantial existing customer base is one of the most obvious advantages. Many telecoms also have robust international setups, which can ease access to markets that could otherwise have been too expensive and difficult for your company to pursue. For back-end solution developers, telecoms’ extensive technical experience and expertise can be a veritable gold mine.

In both instances, telecoms have a lot of experience with what does and does not work. That applies to both technical aspects (like scaling your current solutions), as well as ongoing R&D and business areas such as marketing, sales, and customer interaction. Another potential benefit is data related. Most telecoms have vast troves of customer data, which can potentially be beneficial to your company post-acquisition.

It should be noted that there can be a lot of T’s to cross and I’s to dot before gaining access to said expertise, data, or customer base. Telecoms adhere to strict compliance and data protection regulations, especially since the introduction of new data protection legislation like GDPR. Furthermore, they are businesses which, due to their large size, generally move at a somewhat more pedestrian pace than is the modus operandi for most software companies.

In the immediate time after a signed agreement, both parties in a software—telecoms acquisition can leverage other synergies to streamline business processes and lower costs in areas like marketing and sales.
Telecoms companies need to balance opportunity and risks concerning business decisions that can affect other parts of their organisation, as well as compliance with current and coming rules and regulations. Covid-19 has dramatically altered the risk landscape, as detailed in the BDO Global Risk Landscape 2020 report. BDO is working closely with our clients on addressing those changes. Our first-hand impression is that consolidating and accelerating digital transformation of existing business operations are among the immediate priorities.

The perceived risks and ongoing risk mitigation efforts may, in turn, affect how quickly you will gain access to internal resources. For example, it may influence access to a telecom's data stores. However, one of the main reasons behind many telecoms' acquisitions of software companies is their desire to better leverage and take advantage of their vast troves of data. In other words, you can generally count on access—albeit perhaps a little slower than you may be expecting.

Similar issues can affect other areas, as you become part of a large organisation with many more interconnected parts. Currently, some of those parts may be in a state of flux, as telecoms work to optimise costs, strengthen capacity, and work out how Covid-19 may affect the roll-out of new technologies, including 5G networks. These considerations may, in turn, influence the speed of roll-out or integration of your solutions. This can in some cases be linked to how your services and solutions can potentially lower revenues in other parts of the business—a situation that could lead a telecoms company to delay roll-out or limit your solution's access to specific markets in the short term.

Being part of a big organisation also means that there will be competition for available resources and expertise. Your company may, for example, have quick access to the telco's sales, marketing, and PR expertise to enter a new market as a post-acquisition goal. Once the acquisition process is completed, you may find yourself at the back of a long queue of other departments wanting access to the same, sparse resources.

During the acquisition negotiation process, your company should seek to lay out a road map for what internal services you are looking to access post-acquisition— as well as when. Detailing best and worst-case scenarios for the allocation of desired resources will help identify how various scenarios can affect your ability to reach your – and the telecoms' - goals for the acquisition.
Dealing with a global pandemic has likely made the situation even more stressful for management teams. Groundwork and preparations must begin well in advance of sitting down at the table and starting negotiations.

Part of your preparation is figuring out which areas a telecoms company will focus on during due diligence and contract negotiations. In an ideal world, software companies should start planning the process and preparing necessary documentation at least a year in advance of talks. Due to Covid-19, your company may be financially distressed and need to speed up preparations and negotiations. Furthermore, negotiations may switch toward online instead of in-person meetings.

In any case, allying yourself with an outside consultant who not only knows what needs to be done before negotiations begin but can help speed up the process – including at the negotiation table – may be beneficial. A consultant will also be able to assist in the process of sounding out potential buyers, thanks to their extensive network of business contacts.

Navigating contract negotiations, evaluating client and product risk, documenting regulatory compliance, managing documentation requirements, preparing for due diligence, and carrying out subsequent negotiations is an immense undertaking of interconnected parts. Changes in one area will likely lead to more work in others. In short, your company needs to be prepared if it is to achieve its goals for the acquisition, while simultaneously keeping operations running smoothly.

Leading up to negotiations, software company leaders may want to divide and delegate some of the responsibilities for day-to-day business administration. However, there is no escaping that management teams will have to learn how to do two things at once: run their company while undertaking often intense negotiations. Planning for this reality will lead to fewer surprises and disruptions of either operations or negotiations.

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LEARN TO DO TWO THINGS AT ONCE

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Department hierarchies, tiers of decision-makers, and need for cross-departmental documentation and approval found within many telecoms may seem bulky and difficult to software companies. However, they exist for a good reason. That said, telecoms’ structure and seemingly pedestrian pace may be a challenge to some software companies, as their past success can have relied on being fast-moving and flexible.

During negotiations, software company management teams face other risks and challenges. For example, employees may be concerned by ongoing negotiations, which could affect their future. If inter-company communication is mishandled, they may seek employment elsewhere. This loss of focus on the efficient day-to-day running of a company can lead to future difficulties if the acquisition process ends without an agreement. Companies need to work with a regularly updated Plan B of what to do if negotiations break down.

If talks end with a deal, and you become part of a telecoms company, there are other risks to consider. For example, your team may be split up. Some key employees may be moved to other projects or departments, thereby limiting your efficiency and ability to innovate. As previously mentioned, becoming part of existing organisational structures can be challenging. Not least because it often means losing direct, full control over some decision-making processes. Becoming part of a larger organisation may also, in extreme cases, mean that taking your product or solutions to market can face delays if they threaten existing revenue streams.

Other risks include a lack of necessary resources – both monetary, time, and staff-related - to handle merger and post-merger processes. Finding your place in a new hierarchy and establishing your worth within a large organisation may take time. Also, you may be met with unrealistic targets and short-term goals or a lack of organisational focus. These can create widespread uncertainty and dissatisfaction among your employees, as well as for you.

Addressing such risks and setting realistic, short- and long-term goals during deal negotiations minimise unforeseen surprises and hindrances to your ability to meet post-acquisition ambitions and targets.
Your products and services are often the main reason why a telecoms is interested in purchasing your company. Behind your software products lies much work, code and potential pitfalls which must be addressed during M&A negotiations. That is doubly true for your intellectual property (IP) and what rights will be – and can be - transferred to the acquirer upon agreement.

Valuation of IP will play a pivotal role in an M&A process. Calculating it includes looking at revenue generation, anticipated revenues, royalty earnings and license fees (payable or receivable) and expected benefits for the acquirer – both now and in future. Other areas that will be considered include IP-related patents, patent applications, trademarks, and certification marks.

Your software and IP will be focal points during due diligence. A telecoms – as any buyer – is looking to ensure that they are purchasing IP, associated rights, and software solutions free of future extra charges or litigation risks. Addressing such areas can start by asking yourself questions such as:

- Is my software created from scratch? Often, software builds on existing libraries of code, or rely on third-party solutions. Such dependencies may lead to IP issues after an acquisition.
- Who assisted in the creation of the IP and what are their rights? Consultants, external experts, and independent contractors may have been engaged in developing the IP and potentially hold contractual rights pertaining to the use of or sale of the IP.
- Is my software dependent on other solutions? The answer will often be yes. Possible IP dependency should be explored, and exposure mitigated.
- What data sources exist – and are needed? Data, data sources, and data processing may need to be aligned with a telecoms' existing framework – in part to avoid potential regulatory risks.

During a negotiation process, a telecoms will likely request copies of all material license agreements and all other IP-related agreements. Be aware that such documents may include the likes of R&D agreements, strategic partnerships, and joint venture agreements.

A potential buyer may seek to have technical experts to review your IP, code, and solutions early on during negotiations. As is the case for legal matters pertaining to IP, you may want such experts to be independent to provide insight without bias.
Increased sales and cost-saving synergies are often among the main drivers for both parties of a deal. The same applies to software – telecoms M&A. Achieving the best results requires early groundwork for post-merger synergies. The process includes looking at sales channels and targets for your software. These avenues can be internal, in which case, there should be clear guidelines for what departments and systems your solutions are aimed toward and what payment structures will govern inter-departmental sales. Customer-facing solutions should seek to define areas such as cross-selling opportunities, as well as direct sales targets and roadmaps.

One area to consider is sales support systems. If the goal for your company’s solutions is entering new markets, cross-selling, or becoming part of sales bundles immediately post-merger, there may be a need for training, new marketing materials, and preparation of sales leads. Telecoms’ sales teams, as well as your own sales team, can be integrated or work together on leads earlier than would otherwise be the case if the groundwork is laid correctly.

As is the case with other areas of the negotiation process, certain information necessary to create the best, fastest possible synergies, post-acquisition, can be hard to share during negotiations – you may, for example, fear it leaves you exposed, should negotiations fail. A clean team can be used for parts of the negotiation process to avoid such issues. A clean team is an entity of experts that are legally separate from both parties in the deal negotiation. The team is free to analyse data (after signing necessary NDAs) that negotiation parties are otherwise reticent to share and make recommendations for integration processes and targets based on that information.

For savings, central areas include choosing what functions to centralise and which to outsource to each company/division in the future setup, management, and reporting structures, as well as operating models.

Synergies and savings may extend to your software solutions, where bandwidth and server costs can be among the expenses lowered, post-merger. Consolidating systems can create savings, but it invariably also means spending time and resources on fitting your solutions and code to an existing IT ecosystem.
Compared to life before an acquisition, software company decision-makers will likely be spending a lot more time post-acquisition documenting and seeking approval from other departments than they did before.

It is not necessarily something unique to telecoms but a feature of most large organisations. The same goes for other formal requirements of a large telecoms that may come as surprises. There may be an increase in meetings, as well as compliance requirements that extend far beyond decision-makers. Programmers, for example, will, often, also be required to produce increased amounts of documentation covering ongoing assignment and tasks on specific products and solutions. The same may apply to other staff groups.

For software companies, this can be a bit of an eye-opener and something they should prepare for ahead of the integration process—a process that involves a lot of documentation work.

Many companies, including telecoms, are busy integrating work-from-home options, which may lead to new documentation and reporting requirements. While this is for most places a work in progress, inquiring about such structures and elements during negotiations may save both leadership and employees from being surprise post-acquisition.

For founders, this may need to be a focal point during an acquisition process. Documentation requirements must be clarified, specifying how documentation is to be completed and by whom, who is responsible for oversight and compliance, and how often reviews will take place.

It may also be a good idea for the software company to investigate whether increased documentation requirements necessitate additional administrative staff after the acquisition.

Software companies may be surprised by telecoms’ reporting requirements, which will likely also apply to them post-acquisition.
The classic Mark Zuckerberg maxim of “move fast and break things” rarely works well within a telecoms company. Software companies need to make sure they are prepared for the cultural changes that will almost invariably take place post-merger. At the same time, they should ensure that their unique aspects that foster innovation and enable fast growth are not lost.

If you are an R&D-intensive company, it may be a good idea to ensure that you will be integrated as a separate department with clear goals and deliverables. This approach will likely be met with approval from the other side of the negotiation table. Telecoms are acutely aware of the cultural differences and do not want to lose your innovative spirit, so will often be interested in finding ways to maintain it post merger.

Before a potential acquisition, a software company should try to clearly define what its culture is, what parts of that culture makes it successful, and how it can best maintain those parts after an integration.

That process can be used as a starting point for a negotiation with the telecoms company about how best to merge the two cultures. One possible way of achieving this is by setting a list of targets or integration goals, identifying key strengths, as well as similarities and differences, and making joint decisions on how to integrate the two business cultures without losing the best qualities of each.

Being realistic is important, so a good starting point could be joint discussion about what parts of existing cultures you are willing to cut, what you will look to keep, and what you will want to create. The latter category could include initiatives to boost shared cultural values.
Following a merger, some software companies must wait for value creation and synergies to manifest themselves. Often, the software integration process—in other words integrating your solutions and systems into the telecoms’ IT ecosystem—is the sticking point.

Creating a successful foundation for software integration takes close attention to a wide variety of areas, including your code and software, the telecoms’ existing software and IT-ecosystem, KPIs, and value creation targets.

Software integration involves aligning code, solutions, development technologies, migration processes, governance mechanisms, and platforms—to mention just the tip of the iceberg. Developing a strategy for integration early on and ensuring support and collaboration with relevant, technology experts within the telecoms is pivotal. Some of these areas will be addressed during due diligence, where the telecoms’ technical representatives may look at the architecture and code. It may emerge that software solutions from either party need to be architecturally overhauled for the integration to work, which can cost significant time and effort.

The IT ecosystem that you will become part of is often large and sprawling. To avoid internal confusion and competition, your software company can conduct an IT ecosystem review of the telecoms to identify any risks for both migration and future product sales and integration. Are there, for example, existing, competing solutions? If so, your products should, hopefully, be clearly and explicitly prioritised. In many cases, the tasks mentioned above will involve some ‘flying blind,’ as neither party will necessarily reveal all code, software, or details about general IT setup during negotiations—especially during the earlier stages.

Setting KPIs and goals for value creation will be tied with how and where you add value to the telecoms. Front-end and back-end system and software companies will have different focal points, but a general guideline is to avoid consolidation-first approaches where a buyer insists on your software being fully integrated before revenue starts to count toward benchmark targets. Instead, prioritise agreements for continuous review of targets for revenue and sales (including for cross-selling between departments or as part of bundles with other of the telecoms solutions). Such structures may help incentivise more parties to participate in the onboarding process and increase your senior-level visibility.
Are you entering a deal that can take the company to the next level? Are you selling to cash in on all your hard work and get an earnout? Or do you want to start a new business venture? These relatively simple questions introduce variables to M&A negotiations. What is the timeframe for reaching the next level, for example? What defines the next level? How long of an earnout are you willing to accept? These are just a few initial questions that need answers. Otherwise, both you and your company risk a deal negotiation that will be more difficult and time-consuming than necessary.

During the negotiation process, it is essential to clearly outline what your roles, responsibilities, core offerings, and targets will be post-acquisition. One of the critical areas is to identify and detail expectations and objectives for your services and products post-merger. Pricing and KPI targets, as well as how to measure them, should be agreed upon during negotiations. While it may sound relatively straightforward, the exact nature of selling products and services within a larger organization is something that will take some getting used to for tech companies. Without attention to detail, the pricing of your company’s services and solutions within the organization can become very opaque.

Lack of clarity surrounding measurement of things like costs, sales, and performance will, in turn, affect your ability to reach your targets—including your potential earnout target. Setting clear goals for an earnout based on performance can be very hard to calculate once you are subsumed into the broader organisation, as can renegotiating goals, KPIs, and targets. Making sure these aspects are addressed during a negotiation process is the first step to avoiding later complications and disappointments.

However, the current uncertainty dogging world markets and financial projections may make it difficult to calculate realistic goals and targets accurately. Setting parameters and possibly implementing plans to revisit and adjust targets periodically post-acquisition may help lower uncertainty and reach an agreement that is acceptable for both parties.

Before sitting down for negotiations, a software company needs to be very clear on what it, as a seller, wants to get out of the acquisition—and how best to achieve those goals.
The key takeaway for software companies is that preparation is vital. The same goes for setting clear goals. Once you have decided to sell, you need to spell out what your role and responsibilities will be post-sale. Otherwise, you will end up in a process that is unnecessarily frustrating and challenging for both sides.

The ongoing global pandemic has created uncertainties that may affect every step of an acquisition process. This is one of the areas where BDO’s RETHINK model may be helpful. The model provides a framework for companies to react to the immediate effects of Covid-19, build up resilience to coming changes and realise their full potential.

Even during less tumultuous times, an acquisition process is a long-lasting undertaking and involves many novel tasks for software company leadership teams. The good news is that there is little reason to undertake all of it on your own. By working with a good advisor to consult with during the entire process, you will likely achieve a better result — and have a better acquisition process — than if undertaking it on your own.

Even if you have sold a company before, consultants have gone through the process many times and can help you navigate the challenges with a more objective eye on your company’s strengths, weaknesses and potential worth for a telecoms acquirer. In a perfect scenario, your collaborator will have experience with not just the negotiation process, but also with how telecoms work and think. Insights such as these are vital in every step of the deal.

In short, a consultant will be able to draw on vast experience and expertise to help you overcome many of the obstacles that may arise during a sale and post-merger integration process.

This guidance is by no means exhaustive, and each point mentioned needs a separate set of recommendations — especially as the world struggles with the fallout from Covid-19.