# Top 9 Risks for Global Fortune 500 Companies to Avoid When Buying a Technology Company

It has become common for non-technology companies (non-tech acquirers) to buy technology companies. Unfortunately, non-tech acquirers are often unprepared to assess the technology risks that come with technology company acquisitions, leaving those acquirers vulnerable to various costly missteps. This document discusses the top risks to avoid when making a technology acquisition. It is especially relevant to non-tech acquirers large enough to be in the Global Fortune 500.

## Executive Summary

It has become common for non-technology companies (non-tech acquirers) to buy technology companies. So common, in fact, that non-tech companies are now buying more technology companies than their technology counterparts.[1] Unfortunately, non-tech acquirers are often unprepared to assess the technology risks that come with technology company acquisitions, leaving those acquirers vulnerable to various costly missteps. The mistakes include buying the wrong company, overpaying or an inability to execute on post-acquisition plans.

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## The Rise of Technology Due Diligence

It takes technology talent to assess technology risks, but many non-tech acquirers lack tech talent for such intensive evaluation. When companies such as Microsoft, Apple, Google and other tech giants were doing the majority of technology company acquisitions, there wasn't sufficient demand to create technology due diligence services. As a result, non-tech acquirers were forced to take their chances and rely on "market validation." Market validation is using external indicators such as market share and increasing revenue as proof of internal technology quality. But because so many technology risks are invisible, this is a high-risk situation, a fact not lost on repeat acquirers that have learned the hard way.

Based on more than 100 technology due diligence projects performed by Tech DNA, over any given three-year period roughly 10 percent of deals fall through because of the technology risks uncovered by technology due diligence. The high rate of hidden technology risk is exactly what led to the rise of professional and dedicated technology due diligence services over the last few years.

[1] https://www.nytimes.com/2017/01/02/business/dealbook/mergers.html

# Hidden Risks Have Multimillion Dollar Impacts

Technology acquisitions pose major risks to non-tech acquirers because hidden and nuanced technology defects can have multimillion- and multibillion-dollar consequences. Below are the top nine risks to avoid when acquiring a technology company.

1. Business Model Mismatch
   Business model mismatch happens when the technology doesn't match the acquiring company's revenue model. The technology may be excellent, but, in the end, it may not be the right one to support the business model the acquiring company is envisioning.

2. Weak Security
   Most small technology companies do not focus heavily on security because they have fewer resources and are a less attractive hacker target due to their size. The biggest risk comes from security flaws so foundational to the way the code is architected it takes months or even years to remedy. During this remediation time, the acquiring company can be extremely vulnerable.

3. Privacy Liability
   Most smaller technology companies violate numerous privacy laws, most notably Europe's new privacy law, the GDPR (General Data Protection Regulation). If an acquiring company has global reach, the extremely harsh penalties of the GDPR (which now fall on the acquirer) can result in fines larger than that of the acquisition itself.

4. Impossible Integration
   Often, the technology company's valuation is only justified if their technology can quickly integrate with the acquiring company's other technology assets. A common issue is overly-optimistic integration schedules and, therefore, overly optimistic valuations of the technology company. Whether it is overpayment or delays to market, the costs associated with integration issues are usually in the millions, sometimes hundreds of millions of dollars.

5. Cloud Incompatibility
   If the technology company's offering is incompatible with cloud deployment it will likely have a negative impact on the security, operating costs, scalability and uptime of the acquirer. Sometimes the technology may even require complete re-architecting to be cloud ready.

6. Not Scalable
   The technology company must be able to scale to meet the required growth of the acquiring company. Just because it is currently working with X number of users, without looking inside at the code, there is no way to know if it will work with 2x, 5x or 10x that many users.

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7. Obsolescence
   The technology company may have been built using code that is near the end of its lifecycle. This can create significant near-term upgrade costs. The process of upgrading code also displaces innovative effort, resulting in stagnation.

8. Open Source Liability
   Open source code is free to use, but often carries the high cost of requiring a company that uses it to then release their own source code for free as well. In other words, if a technology company uses open source code, the acquirer could be forced to provide for free what it just spent millions of dollars acquiring.

9. Subpar Technology Team
   Last but not at all least, the technology company's team may lack the experience, knowledge and leadership to make good technology choices going forward.

Many of these risks get worse post-acquisition. Acquisitions often result in media coverage, which catches the attention of hackers and open source copyright holders.  This creates the perfect storm: technology built by a cash-strapped startup that likely cut security, open source and other corners in their rush to market, all mixed with a deep-pocket acquirer that can now pay larger settlements.

## Avoiding Costly Mistakes

Professional technology due diligence makes technology risks visible before the deal closes and it is too late.  It enables acquiring companies to:

- Walk away from the wrong deals.
- Renegotiate valuations when technology defects significantly impair the value.
- Require pre–close fixes to shield them from various risks, including risks magnified by the acquisition.
- Set accurate post–close integration timetables and budgets.

Technology due diligence costs a small fraction of the expensive risks that due diligence can help acquirers avoid. For even the smallest acquisitions, say for $50 million, technology due diligence can be well under 1/1000th of the acquisition price. On the other hand, the risks that technology due diligence can help acquirers avoid is almost always in the millions and, on occasion, billions of dollars. Technology due diligence used to be a "nice to have" and now is a necessity.

# Summary

Now more than ever non-technology company acquirers need to conduct comprehensive technology due diligence before buying a technology company. There are a myriad of high-stakes risks that need to be completely vetted prior to making a major purchase. Hiring a professional technology due diligence service provider to uncover these potential risks enable acquiring companies to proceed with confidence and avoid multimillion-, or even multibillion-, dollar mistakes. The due diligence process doesn't have to take long. For example, Tech DNA can start technology due diligence within 24 hours of engagement and the usual process is 2-3 weeks, but can be compressed into a few days.

The bottom line is a little investment in technology due diligence up front can save an acquiring company significant costly and embarrassing blunders.

### About Tech DNA

Tech DNA conducts technology due diligence on behalf of Global Fortune 500 companies, private equity firms and other investors. Clients rely on Tech DNA to understand, quantify and mitigate numerous technology risks. These risks include security risk, open source risk, integration risk, scale risk, cloud risk, architecture risk and obsolescence risk. Founded in 2009, Tech DNA is an elite team of former major technology corporation executives who, together, have evaluated more than 250 million lines of code across countless target technology companies valued, at acquisition, at over $15 billion.

For more information, please go to www.tech-dna.net.

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