Increase Shareholder Value Through Cost Effective IT Infrastructure Spending

OVERVIEW

It is critical for Private Equity firms to understand how much is necessary to spend on a portfolio company's Information Technology (IT) infrastructure in order to achieve the greatest business value. Spending too much erodes profitability, and spending too little reduces profit opportunities. This brief recommends standardized procedures to determine the need.

Understanding the Role of IT

The goal for any portfolio company is to maintain a rational and profitable business model. Therefore, it is important to formally assess the incremental costs and associated value of additional IT spending as it relates to the bottom line, while also understanding that all future business initiatives requiring IT services must justify the cost of that service.

Focus On Your Unique Needs

Typically, when a company is acquired, a quick analysis may indicate that technology spending is too high. But it is important to know factually what the needs are, and what they may be in the future. A common mistake is to calculate based on industry benchmarks, while this information may be helpful, it does not focus on what the portfolio company's unique needs are. The critical factors to look at are: 1) the portfolio company's business initiatives, 2) the technology support requirements for those initiatives, and 3) the commensurate value of the technology dollars spent.

Align Technology to the Business Direction

Aligning technology initiatives to your current business situation, and its future direction, is critical to profitability.

First, determine the approximate ownership horizon of the portfolio company, as this will have a significant impact on all technology investments. If the ownership time-frame is short and implementation time extensive, the investment may not be worth the risk because the project could span beyond the ownership time-frame.

Second, analyze the business direction, including expected growth levels, growth strategies (acquisitions, same store, etc) service offerings, products, etc.

Third, it is essential to define the technical situation, and to determine the technology required to support the business direction. Ask yourself the following sample questions to frame your needs: 1) In its current state, does the technology processing environment support the business? 2) Are business processes aligned to the functionality of the system? 3) Have procedures been clearly defined and documented? 4) Has the organization been trained on the process and use of the system? 5) Does the business software support the business? And 6) Does the technology architecture have the horsepower to support the future processing needs of the business?

Develop A Business Case for IT Spending

The business case should describe the technology options in clear business terms. If the business case can not demonstrate a technology proposition with commensurate value, a decision would be made not to proceed with any changes.

Action would be required when a company is not leveraging its current systems effectively. Maximizing the system is accomplished by addressing process changes and organizational issues. Upgrading the technical infrastructure, which includes hardware, networks and telecommunications, is an option that offers low risk opportunities.

Other options to consider are related to applications: 1) Implement newer versions of software, and improve integration between applications to eliminate manual activity. 2) Enhance or develop management reporting – i.e. the ability to analyze business performance and run the business. And 3) Replace applications which, as with any investment, need to be cost justified within the ownership horizon.

Conclusion

In order to increase shareholder value through cost effective IT spending, it is essential to have an understanding of the approximate ownership horizon, which will determine the complexity of the solution. Solutions are determined by reviewing and understanding the business model and direction, determining the technology options to support the business model, and by selecting the option(s) that support a rational/profitable business model aligned to the exit time-frame.