

# KEEPING ENERGY M&As ON TRACK WITH EARLY IT ENGAGEMENT



**Ramakrishna Avasarala**  
Consultant, SAP- O&G COE

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## Abstract

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The ERP system in the Oil & Gas industry is tightly integrated with a plethora of legacy applications. The Mergers & Acquisitions throw up many challenges in handling the ownership of these applications and carving out the new ERP system post M&A.

This paper talks about the role IT plays in the M&A process. It focuses on SAP as an ERP system and discusses the areas to work on for a successful ERP migration post M&As.

## Introduction: Role of IT in M&As

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The Oil & Gas industry is constantly looking for opportunities to maximize profits and spread risks. Mergers and Acquisitions are an important business model in this pursuit.

Whether it is a divestiture, acquisition, spin-off or a plain merger, IT integration becomes a key business goal. If the integration is not managed well, the entire business plan has the potential to fall through.

In case of acquire and spin-off, the parent company drives the IT integration to iron out the wrinkles. For divest and merger, however, the new entity has to battle it out to give shape to the fresh IT model and make it sustainable.

M&As are often long drawn and have many phases. It is, thus, important to get the IT organizations on both sides involved from the due diligence phase itself. And IT plays an increasingly important role as the process progresses.

IT engagement during early stages helps:



Evaluate infrastructure requirements and look at cost optimization, leveraging cloud-based infrastructure planning.



Negotiate application licenses with application vendors.



Identify application system complexity, available documentation and ensure the right System Integrator (SI) is selected for support and comes on board before the Transition Service Agreement (TSA) exit.



Formulate the TSA to protect the interests and ensure sustainability of the newly-formed entity.

# Key focus areas from SAP Perspective

During the M&A process, the IT organization of the new entity needs to work on some key areas.

One such area is **application licenses**. It needs to be seen if SAP, Middleware and other application licenses have to be transferred to the new entity by the parent. It also needs to be understood what the bolt-on applications in use are -- like IS OIL Quantity conversion routines, Prometheus (work scheduling in plant maintenance), Vertex/Taxware (input/output tax calculation engine). Subscription to PLATTS/OPIS quotes might be required to base the formula pricing of Crude and Refined products.

There could be proprietary interfaces which need separate license to be negotiated with the respective vendors. In a typical downstream company/refinery there will be many business critical systems tightly integrated with SAP such as yield accounting systems like Sigmafine/Aspentech, terminal automation systems like DTN and Retail applications like PDI, etc. The questions to ponder on are:

- How will the ownership and licenses of these applications be transferred?
- Are any custom built applications going to be omitted during carve out and ownership transfer?
- If so, are they business critical or used for legal reporting?

The other area is **system carve out and preparation**. The important points to be considered during this process are:

- How to handle shared master data between the two entities - like vendors, customers and products.
- Who will perform the SAP data carved out? Will it be performed by the parent entity?
- How to handle credit limits of common customers and re-price common products.
- How to reconcile open receivables, value closing inventory.
- Will historical data be omitted during carve out? If so, will it have any legal ramifications? Is it critical for resolving open customer billing disputes and compliance matters. Typically, inspection dates and audit inspection follow-up history for critical assets being transferred like pipelines and refinery equipment are stored in SAP. This data is very crucial and to be provisioned for transfer to new system of record.

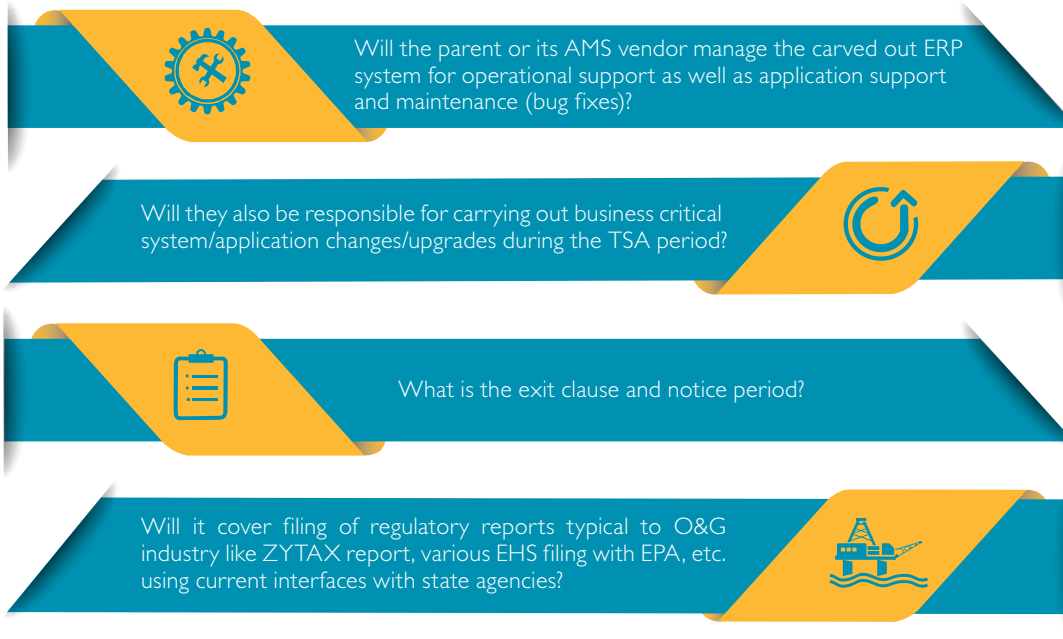
- Inventory ownership and transfer: Unlike manufacturing industry, a typical refinery or terminal would have millions of dollars worth of tank inventory and almost an equal amount on high seas/in-transit. How to prepare SAP to allow transfer of this ownership on the cut over date needs to be pondered over.
- Excise and Input/Output tax calculation is a complex process in Oil & Gas. Generally for US Geo, I/O tax is handled in external systems like Vertex/Taxware, which are integrated to SAP. Excise tax handling is done in SAP-IS OIL's TDP module. Post M&A, the new entity might come under different excise status for which necessary changes have to be made in SAP application and tested.

There might be a need to modify certain configuration items like payment terms, discounts and pricing procedures due to change in the business model. Changes to logos/names on custom forms like PO print outs, customer invoices will be needed from the very first day the new entity comes into existence.

There are typically two options for SAP carve out. One is using SAP's System Landscape Transformation tool. This is generally given on lease by SAP and the work is performed by SAP's own consultants. The other option is, replicate the configuration in new system, import the custom code, migrate master data and open items. Generally, historical data is not included in this. But we need to ensure if this data is critical for any legal requirements, resolving billing disputes, trend analysis, demand forecasting, etc.

Formulation of Transition Service Agreement (TSA) too needs attention. TSA is an interim arrangement between the two entities -- typically for a one-year period. During this time, the parent entity hosts and supports the newly formed entity's IT systems and also some of its business functions. Post expiry of TSA, the new entity has to manage and survive on its own. Often TSA comes at a hefty price, so the new entity is on the lookout to set up its house quickly and opt for an early exit.

From an IT perspective, important points to ponder on while formulating the TSA are:



**Knowledge transfer** is another important area of any M&A activity. It needs to be seen if there are business process documents, configuration and development documentation, and if the parent entity would provide this documentation to the new AMS vendor. If not, then there would be a need to select the new vendor who has the capability to quickly understand the system and business processes through reverse engineering, and create the required documentation.

**Infrastructure** is an integral part of this IT management process during any M&A activity. It is necessary to see if the new system will be on premise or on cloud, if there is a business contingency plan in place and bandwidth/connectivity to support and user teams. One needs to check if the SI vendor and power users access the TSA system while it is under the parent entity's control.

While the TSA is in operation, it is required to replicate the existing development and quality assessment systems for knowledge transfer to business and support teams so that they can test the integration with legacy systems.

After an M&A there would be a need for new security roles, new release strategies in procurement and modified workflows due to a change in business model and size. Thus, **Change Management** becomes an important part of the process. In a combined entity, the business users might not be actively engaged in SAP as this is generally performed by the BPO teams. But after carve out, it could be expected that business users of the new entity might have to perform these functions directly in SAP. This throws up new challenges due to usability and training. So businesses need to be trained not only on the new processes but also in basic SAP.

**Even as the M&A process rolls out, the Day 1 readiness check list needs to be put in place.**

There are separate checklists to be prepared for post M&A and post TSA, including detailed cutover plan and ownership. Post M&A readiness check list should have all data objects (identified in data carve out section above) to be changed to have the new entity functional during TSA. Post TSA check list would involve cutover and production system migration.

There is need for business contingency planning, factoring in some application and system downtime. The interfaces with legacy systems should be stopped. The contingency plan should have process to capture the data during the migration and then replicate it once the system comes up.

The migration could be using one of these methods:



**Lift & Shift:** Physically move the production system from TSA data center to the new entity's data center. Ensure you have a full data back up and contingency plan, in case something goes wrong in transit.



**Backup & Restore:** Back up the data from TSA system and restore onto the client's system which has been set up afresh. Ensure data integrity during the restore process by setting up necessary validation process. This is also required for audit/regulatory compliance.

There is a need to ensure that inherited applications align with the long-term business strategy and IT roadmap of the new entity. This can be done by looking at application rationalization opportunities.

## Conclusion: Value Proposition

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M&As are mostly driven by financial considerations and often IT comes into play very late in the game. This leads to knee-jerk planning and subsequent increase in overall costs. It may also seriously threaten the viability of the whole endeavor. Hence, engagement of IT at an early stage of the M&A process is very important since it:

- Lowers TCO
- Prepares business and external partners to handle the system changes and adopt quickly
- Evolves a sustainable IT model that can function post TSA with minimum business

Selecting the right ERP carve out process and a competent System Integrator to support this exercise are also very crucial.

## About the Author

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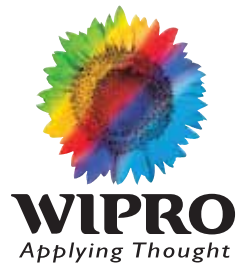
**Ramakrishna Avasarala**, has about 25 years of experience in the Oil & Gas industry. Of this, Ramakrishna has spent 14 years working on SAP projects with Global clients in consulting and project management. Currently, he is part of WIPRO's CoE for SAP Solutions for downstream clients.

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WIPRO LIMITED, DODDAKANNELLI, SARJAPUR ROAD, BANGALORE - 560 035, INDIA. TEL : +91 (80) 2844 0011, FAX : +91 (80) 2844 0256, Email: [info@wipro.com](mailto:info@wipro.com)  
North America Canada Brazil Mexico Argentina United Kingdom Germany France Switzerland Nordic Region Poland Austria Benelux Portugal Romania Africa Middle East India China Japan Philippines Singapore Malaysia South Korea Australia New Zealand

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