

Anna WRYCOL
SFW Energia Sp. z o.o. w Gliwicach
wrycolanna@gmail.com

VIRTUAL DATA ROOMS IN MANAGING DUE DILIGENCE PROCESS

Summary. The article tackles the issue of implementing virtual data rooms (VDRs) in due diligence process. The purpose of this article is to analyze benefits and limitations of VDR, as well as study VDR application in Poland. The examination of VDR usage confirms that this tool has still small share in the total number of M&A transactions in Poland. However, considering the advantages of VDR, an optimistic scenario of VDR development in Poland can be anticipated in the forthcoming years.

Keywords: due diligence, virtual data rooms (VDRs), physical data rooms (PDRs).

ZASTOSOWANIE WIRTUALNYCH BAZ DANYCH W ZARZĄDZANIU PROCESEM DUE DILIGENCE

Streszczenie. W artykule podjęto kwestię zastosowania wirtualnych baz danych w procesie due diligence. Celem artykułu jest analiza korzyści oraz ograniczeń VDR, a także zbadanie stanu wykorzystania VDR w Polsce. Przeprowadzone badania świadczą o wciąż stosunkowo niewielkim udziale VDR w ogólnej liczbie transakcji w Polsce. Z uwagi na istotne korzyści wynikające z zastosowania VDR w procesie fuzji i przejęć można zaprognozować optymistyczny wariant rozwoju VDR na rynku polskim w nadchodzących latach.

Słowa kluczowe: due diligence, virtual data rooms, physical data rooms.

1. Introduction

The process of due diligence is an important process before a company is evaluated. The efficiency of such an analysis on developed markets makes a premise that it can be successfully implemented into companies performing activities on the Polish market. Under Polish conditions it is still underestimated or treated superficially in the case of mergers and acquisitions. Due diligence is worth noting not only from the investor's perspective, but also

from vendor's point of view. Owing to the fact that due diligence is the complex and detailed analysis of the target company, this tool allows for better assessment of the investment, as well as identifying chances and risks stemming from such activities. As due diligence is multidimensional, the core of the analysis is to attain the most reliable data concerning the company's performance. The preliminary presentation of the gathered data allows for better estimation of the milestones in the analysis and the strategic congruence with the established aims. It also enables to sift and eliminate the minor data that will not have an influence on the company's performance and decisions made. It is important to organize the place where the documents are available. The access to information can be four-dimensional:

- Traditional data room (PDR)
- Virtual data room (VDR)
- Site visit
- Interview with the employees

The purpose of this paper is to discuss the challenges of VDR application for the efficiency of due diligence process.

2. Specificity of Data Rooms

There is no strict definition of data room. Different specialists adopt distinct approach to data rooms in due diligence. However, the most universal meaning is that data room is "a self-contained facility (room, building) that accommodates centralized IT equipment (Servers, Networks and Storage) and an ancillary site infrastructure (power delivery system and cooling system) to allow a reliable provision of the following services: storing, processing, or exchanging of digital data and information" [5]. Data rooms can be comprehended traditionally as physical data room where the information is viewed by potential buyers and virtual data rooms.

Physical data rooms are one of the most important issues in due diligence research. They give an opportunity to present the vendor's company. Physical data rooms enable to have an insight into the documents that are inserted in paper version in files, binders or portfolios. The documents comprise of data that are legally acknowledged as a confirmation of the company's assets and financial performance. The appointed team appears at the place the documents are kept and conducts a detailed analysis. It usually takes place in a narrow circle of analysts in order to maintain the confidentiality of the research. Therefore, none of the documents can be carried outside the room or copied without permission.

Moreover, while viewing the documents, the team should have their aims and points in analysis specified. If the outline and general financial situation of the company are known, the team is able to allot the time in physical data rooms for more detailed examination of

operations conducted by the company. This allows, in turn, for discerning and verifying the risks and chances the company bears. Therefore, due diligence carried properly means that each document in physical data room has been examined. In practice, the analysis of each document is rather unfeasible, which sometimes engenders disappointment with the transaction. There are some standard documents launched in physical data rooms, albeit the documents available differ depending on the analyzed object.

It must be mentioned that it is not only the role of the seller to organize data room in order to learn about the vendor's company. Data room preparation is also required from the purchaser's company. It constitutes the right of the vendor to get to know about financial and operational aspects of the buyer's company. For the purpose of maintaining information confidential, it is advisable to appoint the person who will coordinate the flow of information. Such person should not permit the situation when data are stolen from physical data room or transmitted without consent.

Data compilation is not easy, since it takes a lot of time to choose the scope of contents available, copy it and characterize it in the right way. Both of the parties should receive a list with indexed information about the documents available, as well as the possibility to copy them.

When it comes to the team of analysis, one can make a distinction between strategic buyers and financial buyers [11]. This division depends on the approach of given investors to the transaction. Financial investors analyze the company's performance at an angle of the prospective sale with higher price and profit. Therefore, the financial aspects of the company's performance pose a priority for the financial team. Strategic buyers, in turn, focus mainly on the future synergy of the companies. Thus, the team examines the company to be bought regarding its technical supply and operational systems.

3. Application of Virtual Data Room vs. Traditional Data Room in Due Diligence Analysis

Virtual data room is the tool in due diligence analysis which uses computer software and global technology to facilitate the research and create a secure information sharing system. VDR provides online format for reviewing and organizing information during due diligence process [16]. Virtual data rooms have rather short history in the M&A field. They appeared as a result of progressive globalization and increasing share of mergers and acquisitions in the market. In Poland the history of virtual data rooms seizes October 2009 when Datapoint received the certificate of Extended Validation SSL to perform internet services [6].

Development of mergers and acquisitions transactions, as well as constant improvement of technology and fostered processes of globalization have caused that virtual data rooms are

gaining more and more supporters. Virtual data rooms have more profits in comparison to traditional data delivery in the M&A process (Tab. 1).

Table 1

The comparison of PDR and VDR in due diligence process

TRADITIONAL DATA ROOM	VIRTUAL DATA ROOM
<ul style="list-style-type: none"> • it takes much longer to pass the information to all parties involved 	<ul style="list-style-type: none"> • more effective, the time needed to transmit data is shorter and the information can be addressed to wider group of recipients;
<ul style="list-style-type: none"> • the access and possibility to copy the document is not restricted; thereby there is a danger that the confident data will be distributed to improper and incompetent people 	<ul style="list-style-type: none"> • the possibility to copy the document is limited, all attempts to access or print the documents are noted or reported; all users have passwords, therefore the level of security is higher;
<ul style="list-style-type: none"> • worse accessibility, the information is not updated instantaneously 	<ul style="list-style-type: none"> • the information is updated immediately and shown in VDR successively
<ul style="list-style-type: none"> • higher costs have to be allocated in the M&A process 	<ul style="list-style-type: none"> • more economical; there is no need to waste myriads of paper sheets to print and pass the documents; thus the costs of conducting due diligence are lower;
<ul style="list-style-type: none"> • it imposes restrictions in communication 	<ul style="list-style-type: none"> • it allows for communication both in the nearest environment as well as in the international area
<ul style="list-style-type: none"> • it causes impediments in the case of wide scope of information 	<ul style="list-style-type: none"> • no limits concerning the scope and extent of data

Source: own elaboration.

Firstly, when PDR and VDR are compared, the second one is more efficient and productive. The access to information in VDR is easier and faster. The documents may be browsed simultaneously by different analysts, while in PDR the documents pass on in cycles. When one of the analysts completes the research, the documents are delivered to the next one. VDR not only allows for a wider array of the documents, but also is more economical as it does not generate costs connected with copying the materials.

Virtual data rooms can be organized within the vendor's company which prepares the documents and makes them accessible or by the external institution appointed for this aim. Using the support of an external virtual data room is currently more popular than the internal one. Usually the implementation of virtual data room entails six stages [11]. At first, a formal appointment with all participants in virtual data room is made. At the meeting the invited members are introduced and given the instructions how the process of applying VDR looks like. Key issues are discussed during the conference such as the number of documents to be scanned, the number of participants who will have an access to VDR or the duration of due diligence via VDR. Subsequently, the contract between the users and the organizer of VDR is

signed, after which the virtual data site is created. The recipients' needs are assessed and all necessary documents are scanned and inserted in the database. Finally, the VDR providers should exercise control over the data available. The final phase is the longest one. The rudimentary task in this step is to maintain the flow of information, include the answers for questions that have been posed during due diligence and insert new documents in database.

According to the company Idrshare one of the virtual data rooms organizers, there are certain features defining virtual data room such as [8]:

1. Uploading and sharing documents;
2. Publishing and tracking documents access;
3. Tracking and auditing documents access;
4. Inserting questions and answers;
5. Controlling panel;
6. Email notifications and alerts;
7. Watermarking;
8. Searching function.

The documents are included and shared via virtual data room. One of its most important feature is the possibility to control and monitor the documents inserted in VDR. Users are able to track the documents by popularity, date and providers of data. This helps not only purchasers, but also vendors who make the profile of the prospective buyers and prepare to the subsequent stage of due diligence without disclosing confidential data to incompetent buyers. The published documents constitute the proof that they have been read. It is vital particularly when there are some legal impediments during due diligence and finalizing the transaction. As the use of VDR is limited the documents cannot be copied and printed. It prevents an illegal distribution of confidential data concerning the target company. An interesting function of VDR is a constant opportunity to ask questions by VDR users. Through "Q&A" icon, questions and answers can be monitored directly and regularly. While asking questions and giving answers there is a simplified way to refer to given documents.

VDR maintains the privacy of the documents, since there is an entire control over who can read, change and insert the information. A useful function of VDR is getting notifications via e-mail. If the content of the virtual base has changed, the users receive an e-mail message with the new documents and scope of the material. New documents' alerts are included to VDR, which allows to save time consumed for searching myriads of documents. The new documents are visible when the user enters the virtual data room.

Another useful feature of VDR is watermarking. By printing certain words which could be the name of the user and the date of retrieving the document, one can identify the source of distributing the document.

The search function enables to quickly find the issue the users are interested with. By computing the word or phrase the needed documents are shown. What is more, VDR allows for storing the files in different formats like Excel, PowerPoint, Word or PDF which

eliminates the necessity to convert the documents thousand times into the expected format. In addition, while checking out, the documents maintain in unchanged form or with changes if they are deliberate, intended and confirmed.

4. Applicability of VDR on the Polish market

In the first years of the analyzed period the number of mergers and acquisitions in Poland was quite high reaching to 581 in 2010. Since 2012 a rapid slowdown has been noted. These years have been rather disappointing in the context of the number of mergers and acquisitions. The phenomenon perceived is the result of consolidation trends since 2012. In the last 2014 year, the sectors which attracted attention and noted the highest number of transactions were services, including financial services, food and beverages, wholesale and retail, insurance, healthcare and manufacturing [1].

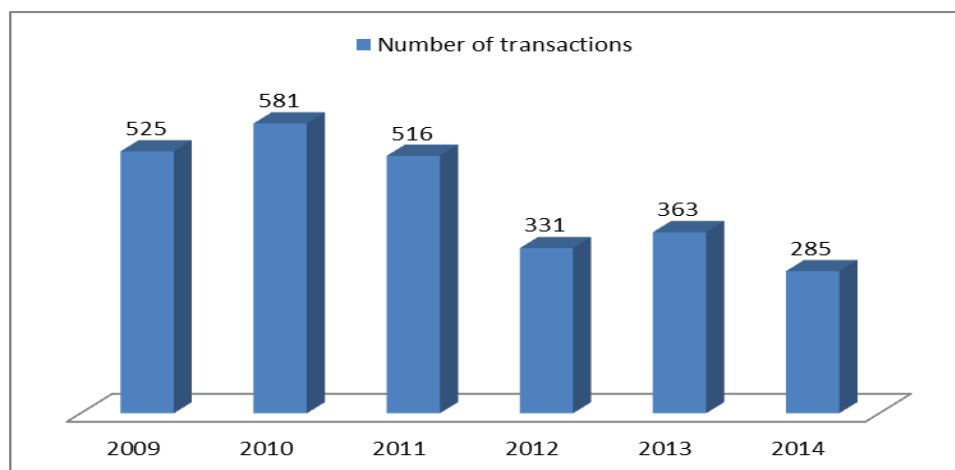


Fig. 1. Number of M&A transactions in Poland in 2009-2014

Rys. 1. Liczba transakcji M&A w Polsce w latach 2009-2014

Source: own analysis on the basis of 1. CMS Poland, <http://www.cmslegal.com> [retrieved: April 2015].

When the outline of mergers and acquisitions deals is made, along with the number of M&A transactions in Poland for the last years (Fig. 1), it is necessary to analyze the scope and volume of transactions prepared with the usage of VDR. As it has been mentioned before, in Poland the company FORDATA (formerly Datapoint) leads the field. However, the official data presenting the number of transaction made via VDR are accessible since the second quarter of 2014. The number of transactions conducted via VDR is presented (Fig. 2).

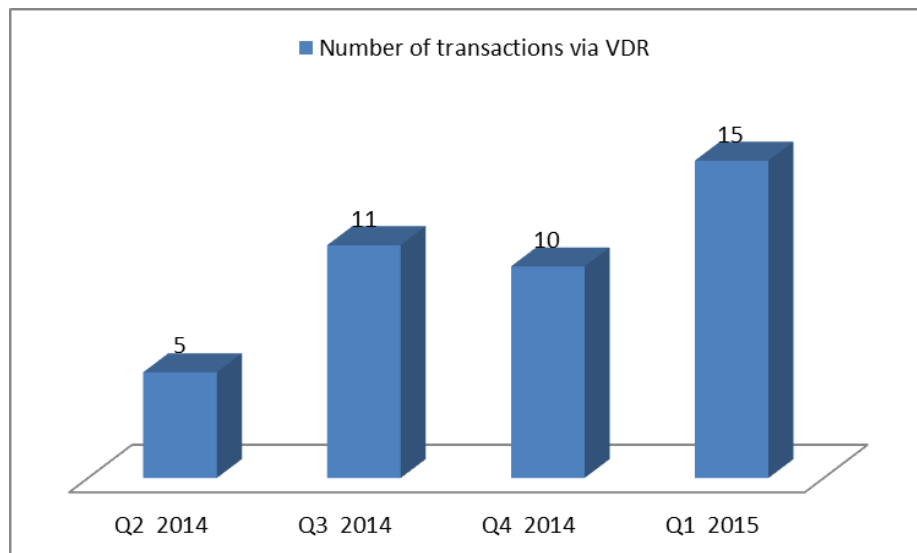


Fig. 2. Number of transactions in Poland via VDR Q2 2014- Q1 2015

Rys. 2. Liczba transakcji w Polsce za pośrednictwem VDR, II kwartał 2014 – I kwartał 2015

Source: On the basis of FORDATA, <http://fordata.pl>, [retrieved: April 2015].

The perspective for M&A activity in 2015 is rather optimistic when the analyzed data are taken into considerations. The sectors which are likely to be attractive from the point of VDR are IT, healthcare, manufacturing (in particular, chemicals), energy, transportation and media. Presumably, consolidation of assets in these and other sectors will foster the M&A market, which uses VDR technology more and more willingly. In the first quarter of 2015, the application of VDR has been higher by 50% in comparison to 2014.

Basing on foreign experience in the growing application of VDR, Merrill Datasite which is the comprehensive virtual data room with worldwide scope, it is estimated that M&A transactions conducted via VDR attract an average of 50% more bidding parties than PDR [14]. In the Polish field, according to the Investment Director of PZU, Marcin Jaszczuk, „the use of the system improved the transaction by increasing its efficiency and shortening the duration of the process” [6], which brings the issue to the point of analyzing VDR’s advantages and drawbacks.

5. Advantages and Drawbacks of VDR

When discussing the usage of virtual data room, it is necessary to recall its advantages and drawbacks from both, the seller’s and buyer’s perspective. Firstly, the benefits and disadvantages for the buyer will be fostered. The advantages include such points as saving in time and costs [9], convenience, clarity and perspicuousness, assurance that the buyers are reliable.

The first significant advantage concerns savings in time and costs. When due diligence is performed traditionally via PDR, analysts are obliged to travel to the place it is located. This generates costs not only connected with costs of delegation, but also the cost that the worker is out of his office and cannot execute some of his tasks. When PDR is in the same city, the problem with travelling is not burdensome and strenuous. The matter exacerbates when the employers have to travel internationally for the purpose of conducting due diligence in PDR. Then, the company bears large and gratuitous costs of airplane tickets and accommodation. In the case of VDR the costs connected with travelling are avoided, since all the necessary materials are available via the Internet, which becomes a great facility to the company's management and workers.

The costs evaded are also linked with savings in printing the documents. In PDR the documents have to be printed and copies can be made, which involves costs of paper and ink. In the case of VDR the documents are transferred electronically, which does not require so much printing.

VDR is much more time-saving than PDR. The analysts are not compelled to turn over the pages of documents to find the necessary information. Instead, the economy of their work is better as they can devote this time to analyzing and drawing conclusions. In addition, the access to VDR is not limited when time is taken into consideration. VDR is usually open all the time for 24 hours, thus analysts may choose the time comfortable for them to work, as well as they can check the essential issues regardless the time. Therefore, VDR creates accommodating terms and gives good opportunities for the buyer making due diligence more flexible, when it comes to scope and intensity of the analysis. In contrast, the team in PDR has to gather the most data in the shorter time, thus the quality of the analysis is frequently poor.

Subsequent advantage of VDR is the impression of comfort. Employers are not obliged to reach PDR place, thus they can work in amiable atmosphere, at their desks or at home. No stress or inconvenience resulted from travelling is included. Convenient environment makes the work performed with higher productivity and effectiveness.

Due diligence conducted with the use of VDR appears to be more transparent. In a traditional approach, the steps taken by analysts are not always clear and perspicuous. Some activities can be concealed. The probability of vague actions during VDR process is minimalized or eliminated at all. Each action has the electronic record, thus it can be followed, controlled and confirmed. The access of a given person to database can be checked, the probability of hiding some actions is minute as all operations can be screened. Transparency also refers to a greater level of formality in the process of due diligence. Buyers and sellers have a clear cognitions of reciprocal actions. They have also analogical access to information, which neutralizes information asymmetry.

VDR gives the assurance that buyers have equal access to information, as well as are allotted the same time for analyzing documents. The team which has an earlier access to PDR has more time to research and verify the documents than the team which schedule is more

distant in time. The analysis cannot take place simultaneously in PDR, which creates the circumstances of inequality and dishonesty.

Undoubtedly, VDR is beneficial for buyers, but this does not mean it comprises advantages only[10]. Despite the fact that advantages of VDR preponderate over disadvantages, shortcomings are perceptible.

The first disadvantage mentioned concerns the final price. The price tends to be more realistic when traditional PDR is used. Buyers have the proclivity to overpay when due diligence is conducted via VDR. As the offer with higher price is chosen, buyers who suggest lower price, but frequently more realistic are not taken into consideration.

Another problem met during VDR is the difficulty of reading the materials. Frequently, documents available online are excluded from printing to warrant the security of data. In this case, it is problematic to read the documents online, as it is more strenuous and tiring for the readers. From psychological point of view, for vast majority of people it is better to print the documents and analyze paper versions. If analysts are tired by reading the documents online, their work becomes less efficient. When the productivity is lower, they may make more mistakes, which finally has a pejorative effect on the quality of the analysis.

Documents in digital form generate an impediment for the older employers, who prefer printed version of data. As it is known, people are not inclined to change their habits. Thereby, the management trying to implement VDR may meet reluctance on the part of those analysts who opt for printing the documents.

Another imperfection of VDR is the lack of possibility to insert some physical materials online. It pertains to such items as products or samples. However, this matter can be solved by organizing site visits during which all physical items can be analyzed and assessed.

If the function of printing the materials is possible, one of the weakness of VDR on the part of the buyers is the need to print or copy the documents on their own costs. When due diligence is performed traditionally, it is the seller who infers all costs connected with distributing the materials. Nonetheless, the disadvantages presented frequently depend on the point of view and perspective. They are not significant to the point that they prevail over the advantages. Therefore, it can be inferred that VDR from buyer's perspective has multifarious advantages and only several weaknesses which can be quickly and easy eliminated.

As the advantages from buyer's perspective have been discussed, this paragraph is to delineate benefits from the seller's perspective. Some of the advantages are similar to the above-mentioned. It entails such benefits as saving in time and costs, simplified procedure concerning organization of due diligence, legal aspects or data security.

The implementation of VDR facilitates the process of due diligence not only for the buyer, but also for the seller. VDR excludes activities connected with renting the room, organizing printed documents and assuring security of the maintained data. VDR improves the organization of due diligence, as the time needed for setup process is shorter than in traditional PDR.

Implementing VDR on the part of the seller is conducive to lower costs and saving in time. Admittedly, the costs are commensurate with the number of buyers participating in due diligence. When there are more buyers involved in the process, the costs increase. However, the same case is adequate to PDR with a difference that if the number of participants is higher, the costs are much more extensive than in VDR. VDR is profitable to the seller when time is taken into consideration. Sellers may save time necessary for printing, copying and supervising physically due diligence process.

VDR is easier for the seller when legal aspects are involved. All the documentation is accessible and stored online, therefore, it absorbs less efforts to prove some actions or confirm information given. The evidence of steps taken is more transparent. Albeit better transparency of documents, it is at the same time more secure. If all necessary measures are taken by sellers such as passwords or firewalls, VDR ensures better security than PDR.

The dominant weakness of VDR on the part of the sellers is the issue of security. The impression that VDR is less secure when it comes to information about the seller, stems from the fact that more people have access to VDR. Moreover, there is no certainty that the assigned participants will work in VDR. The participant may give his password to another, not registered person. When in PDR the identity of the participants can be checked, in the case of VDR the identity of the person who has the access to database cannot be verified, since the other person may work on somebody's behalf. Therefore, the element of confidence and trust is indispensable here. Taking the above disadvantage into account, VDR is favourable and beneficial to the seller even more than to the buyer. The advantages of VDR prevail over disadvantages both in the case of the buyers and the sellers.

When the advantages and disadvantages of VDR are presented, it is high time to assess its usefulness to due diligence and mergers and acquisitions process. There are several points that add value to due diligence and M&A process, such as inspection from sequential to parallel, improvements in process quality, reduction in transaction duration and some theoretical advantages.

First of all, VDR fosters the transition from sequential analysis which is the case in traditional physical data room to parallel. However, in order to make this change entirely applicable and effective, there have to be many buyers partaking in due diligence. When these terms are complied, the parallelism of using data room is particularly perceptible.

VDR is inseparably connected with higher quality of performance. The access to materials stored in VDR is possible 24 hours a day. That means that analysts do not work under the pressure of time and consequently their work is of better standard. Therefore, users are able to utilize their time more efficiently and conduct a more detailed research than in the case of PDR.

6. Conclusion

Taking the above research into consideration, it can be inferred that Polish companies are becoming more and more aware of advantages arising from virtual data rooms. When analyzing the participation into VDR during due diligence in M&A, it is perceptible that the cross section of companies is much wider than at the outset of its functioning in 2009. Currently, the usage of VDR entails various sectors and dimensions of the Polish market. One of the biggest, FORDATA (since 11th September 2014, formerly Datapoint) enumerates among its clients companies from strategic sectors, such as energy, fuel or communication, from banks or lawyer's offices. Researching the structure of clients of virtual data rooms, it can be notified that companies with foreign capital that perform activities in the Polish market are more inclined to apply VDR when conducting due diligence. Admittedly, in the light of the growing interest with virtual data room in due diligence process, it seems that using VDR in Poland as the major data transfer is the matter of time.

Several years period on the market is an interesting turning point in Polish M&A history. The share of VDR in the total number of transactions that have taken place in the recent years as the analyzed data have shown is rather scarce. However, this is still increasing. Therefore, having in mind the advantages it gives, it is worth following the development that VDR will make in the foreseeable future on the Polish market.

Bibliography

1. CMS Poland, <http://www.cmslegal.com> [retrieved: April 2015].
2. Brümmer O.: Virtual Data Rooms in M&A transactions and their effect on information quality. International University Schloß Reichartshausen, 2006.
3. Butler J.W.: Navigating Today's Environment: The Directors' and Officers' Guide to Restructuring. Globe White Page Ltd, London 2010, p. 291.
4. Dale J.: Digital rights management – Unabridged Guide. Emereo Publishing, 2012.
5. Dittmar L., Schaefer M.: Electricity Demand Modeling of German Data Centers: Dealing with Uncertainties. Technische Universität Berlin, 2009.
6. Fordata, <http://fordata.pl> [retrieved: April 2015].
7. Gole W.J., Hilger P.J.: Corporate Divestitures: A Mergers and Acquisitions Best Practices Guide. John Wiley & Sons, New Jersey 2008, p. 134-142.
8. Idrshare, <http://www.idrshare.com/virtual-data-room-products/data-room-features/>.
9. Handford L.: The Advantages of Virtual Data Rooms. Stevens and Bolton [retrieved: <http://www.stevens-bolton.com/uploads/28-07-11-the-advantage-of-virtual-data-rooms.pdf>].

10. Huml R.: The Pros and Cons of Using Virtual Data Rooms for Due Diligence. "Science and Technology", 2008, p. 43-45.
11. Kummer C., Sliskovic V.: Do Virtual Data Rooms Add Value to the Mergers and Acquisition Process? Institute of Mergers, "Acquisitions and Alliances", Zurich 2007.
12. Lucks K.: Transatlantic Mergers and Acquisitions: Opportunities and Pitfalls in German-American Partnerships. Wiley-VCH-Verlag GmbH, 2005.
13. Marks K.H., Robbins L.E., Fernandez G., Funkhouser J.P., Williams D.L.: The Handbook of Financing Growth: Strategies, Capital Structure, and M&A Transactions. John Wiley & Sons, New Jersey 2008, p. 323-328.
14. Merrill Datasite, http://www.merrillcorp.com/2008-archive_393.htm [retrieved: May 2015].
15. Nemethy L.: Business Exit Planning: Options, Value Enhancement, and Transaction Management for Business Owners. John Wiley & Sons, New Jersey 2008.
16. Sherman A.J.: Mergers and Acquisitions from A to Z. Library of Congress. Westport, 2011, p. 83-93.
17. Yates G., Hinchliffe M.: A Practical Guide to Private Equity Transactions. Cambridge, New York 2010, p. 35-40.

Omówienie

W artykule podjęto kwestię zastosowania wirtualnych baz danych w procesie due diligence. Celem artykułu jest analiza korzyści oraz ograniczeń VDR, a także zbadanie stanu wykorzystania VDR w Polsce. Przeprowadzone badania świadczą o wciąż stosunkowo niewielkim udziale VDR w ogólnej liczbie transakcji w Polsce. Jednakże od pierwszego kwartału 2015 roku notowany jest znaczny wzrost liczby transakcji M&A przeprowadzanych z użyciem VDR. Z uwagi na istotne korzyści wynikające z zastosowania VDR w procesie fuzji i przejęć można zaprognozować optymistyczny wariant rozwoju VDR na rynku polskim w przyszłych kwartałach 2015 roku oraz w nadchodzących latach.