Critical Success Factors in Mergers & Acquisitions

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Fung Technical Report No. 2013.10.9
http://www.funginstitute.berkeley.edu/sites/default/files/M&A.pdf

October 9, 2013
The Coleman Fung Institute for Engineering Leadership, launched in January 2010, prepares engineers and scientists – from students to seasoned professionals – with the multidisciplinary skills to lead enterprises of all scales, in industry, government and the nonprofit sector.

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Abstract: Companies merge with or acquire other companies for various reasons, among which include growing their portfolio, entering new markets, or acquiring talents/skills. A large percentage of mergers fail due to various reasons, yet companies continue to get married. This report attempts to capture the key factors necessary to a successful Merger & Acquisition (M&A). We analyze the different types of M&A and the reasons behind each type. The process is also very important to the success of an M&A. This paper derives key success factors from case studies of eight M&A’s and presents several key findings.
Introduction – Mergers & Acquisitions

Companies merge for the sole purpose of increasing their shareholder value over and above that of the sum of the individual companies, i.e., \(1+1>2\). This rationale is particularly alluring to companies when times are tough. Strong companies will act to buy other companies to create a more competitive, cost-efficient company. The companies will come together hoping to gain a greater market share or to achieve greater efficiency. Because of these potential benefits, target companies will often agree to be purchased when they know they cannot survive alone.

Mergers vs. Acquisitions

Although they are often uttered in the same breath and used as though they were synonymous, the terms merger and acquisition mean slightly different things.

When one company takes over another and clearly established itself as the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist: the buyer "swallows" the business and the buyer's stock continues to be traded.

In the pure sense of the term, a merger happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated. This is more precisely referred to as a "merger of equals." Both companies' stocks are surrendered and new company stock is issued in their place. For example, both KLA Instruments and Tencor Instruments ceased to exist when the two firms merged, and a new company called KLA-Tencor was created.

In practice, however, actual mergers of equals don't happen very often. Usually, one company will buy another and, as part of the deal's terms, simply allow the acquired firm to proclaim that the action is a merger of equals, even if it's technically an acquisition. A purchase deal will also be called a merger when both CEOs agree that joining together is in the best interest of both of their companies. But when the deal is unfriendly - that is, when the target company does not want to be purchased - it is always regarded as an acquisition.

Whether a purchase is considered a merger or an acquisition really depends on whether the purchase is friendly or hostile and how it is announced. In other words, the real difference lies in how the purchase is communicated to and received by the target company's board of directors, employees and shareholders.

Part A: Types of M&As

From the perspective of business structures, there is a whole host of different M&As. Here are a few types, distinguished by the relationship between the two companies that are merging:

- **Horizontal M&A** - Two companies that are in direct competition and share the same product lines and markets.
  - *Examples: HP-Compaq, Oracle-PeopleSoft*

- **Vertical M&A** - A customer and company or a supplier and company. Think of a cone supplier merging with an ice cream maker.
  - *Examples: Direct TV-News Corp, NBC-Comcast Cable, etc.*
• **Market-extension M&A** - Two companies that sell the same products in different markets.
  - *Examples: Daimler/Benz-Chrysler*
• **Product-extension M&A** - Two companies selling different but related products in the same market.
• **Conglomeration M&A** - Two companies that have no common business areas.
  - *Examples: Philip Morris-General Foods*

There are two types of M&A that are distinguished by how the M&A is financed. Each has certain implications for the companies involved and for investors:

• **Purchase M&A** - As the name suggests, this kind of merger occurs when one company purchases another. The purchase is made with cash or through the issue of some kind of debt instrument and the sale is taxable. Acquiring companies often prefer this type of merger because it can provide them with a tax benefit. Acquired assets can be written-up to the actual purchase price, and the difference between the book value and the purchase price of the assets can depreciate annually, reducing taxes payable by the acquiring company.
• **Consolidation M&A** - With this merger, a brand new company is formed and both companies are bought and combined under the new entity. The tax terms are the same as those of a purchase merger.

### Part B: M&A Process

The merger and acquisition process can be divided into a few steps. The stepwise implementation of any merger process ensures its profitability.

**Discovery Phase**

In this first step of the process, a company identifies gaps in their portfolio and targets acquisitions. In this phase, the buying company proactively talks to many potential sellers. Talking to many sellers provides information on the industry and technology, if the company is not already in that market. The buying company also assesses the value of the target company. The criteria for exit of this phase are: seller’s willingness to sell, buyer’s business/stock position and timing of events within the buying company.

**First Level Due Diligence**

The company that intends to acquire the target firm engages itself in a thorough analysis of the target firm’s business history. The products of the firm, its capital requirement, organizational structure, brand value - everything is reviewed strictly. This phase typically lasts 1 week.

**Negotiation Phase**

In this phase, companies start thinking about price. This phase is not only about numbers, rather, the buying company understands what else the seller is looking for. Companies agree on the transaction structure – asset, currency (cash vs. stock), conditions to close and employee agreements (title, pay). Companies also finalize the term sheet and exclusivity, if any.

**Deep Due Diligence**

This is the busiest phase of the acquisition process. Both companies finalize the purchase agreement, contract and conduct deep technical meetings. All matters related to Intellectual Property (IP), IT and HR are finalized.
**Signing deal**
In this phase, companies sign the contracts and get regulatory approval.

**Integration**
In this final stage, the two firms are integrated. This ensures that the new company carries the same rules and regulations throughout the organization. This is the longest phase of the whole process. Integration teams must look at integrating HR, IT, legal and engineering.

**Part C: Case Studies**
In this section, we study the following mergers and acquisitions:

- KLA-Tencor merger
- Veritas acquires Precise
- Veritas acquires Ejacent
- Symantec acquires Relicore & Jareva
- Symantec acquires Vontu
- Yahoo acquires Flickr
- EMC acquires VmWare
- Oracle-People Soft merger

**KLA-Tencor Merger – Product Extension M&A**

- **Strategy – Vendors Consolidation**
  - 1996, Applied Materials acquired Orbot and Opal and moved into the metrology/wafer inspection market. KLA and Tencor thought they needed to grow in order to compete with Applied Materials.
  - After the merger in 1997, KLA-Tencor became an important process control player in the industry, bringing to market a complete line of yield management products and services from a single company.

- **Merger Details:**
  - KLA and Tencor were both large companies before they merged. KLA had 2500 employees with $600M revenue, while Tencor had 1400 employees with $403M revenue.

- **This merger was successful** for the following reasons:
  - Merger of two “equals”
    - Both companies had a healthy balance sheet. The merged company has $700 million in cash and no debt.
    - Company emphasized that it is not one company “buying” the other company.
    - Clear roles and responsibilities for senior management
  - Two companies served different market segments
    - No conflict of products or customers. As a result of the merger, they complementarily joined product lines, resulting in a complete line of yield management products
    - One year later, they released a dark field inspection tool that combined technologies from both companies
  - Retention of talent
Good communication throughout the merger is of critical importance in allaying employee fear and uncertainty. During the merger, employee welfare issues, such as benefits, lay-offs, and other concerns arise. A certain percentage of the people involved react with fear and denial, and those who cannot get beyond their initial reactions will likely leave the company. The employee turnover rate spiked shortly after the merger, but then quickly returned to normal.

Transferred a few executives temporarily from their regular duties to a special team focused on merger-related issues. These cross-functional teams, with parallel membership from both of the merging entities, were tasked with implementing the "best practices" that would become the core of the new corporate culture.

Had enough cash to recruit and train enough engineers to meet its growth targets.

- Fostering a new corporate culture
  - Understandably, there is considerable employee resistance to changing an established company's culture. One of the ways KLA-Tencor sought to overcome this challenge was through a "best practices" approach. They examined the processes, procedures, and values of both companies and adopted those that we felt would best serve the new company.

- Take advantage of streamlined management and shared development costs.
  - Field people have been redirected into teams, each team focusing on a single customer.

Proximity
- KLA was in San Jose and Tencor was in Milpitas. The new headquarters is in Milpitas, CA. Employees did not have to relocate too far.

Veritas acquisition of Precise – Product Extension M&A
- Strategy – Portfolio diversification
- Acquisition details:
  - Veritas: Based in Mountain View, CA. Revenue of ~$2B. Leader in Storage Management Software
  - Precise: Based in Israel. Provided Application Performance Software (Server Management). Acquired for ~$537M, revenues at sale: ~$75M in 2003
- Acquisition was a failure due to following reasons:
  - Integration plan did not align with strategy:
    - While the strategy aimed to run Precise as its own business unit, sales teams were merged. This was unsuccessful; neither sales team were cross-trained
    - With sales down, strategy changed to integration with other acquisitions in server management domain. No strong customer use-cases identified, no strong leader identified. No investment in existing use-cases. Revenues become small – not viable to continue developing
    - Attrition due to lack of viable strategy
  - Cultural differences
    - Cultural differences between Israeli group and Mountain View group made collaboration difficult. Lack of a strong leader did not help
- Final Outcome
  - Precise divested to a private equity firm in 2008

Veritas acquisition of Ejacent - Product-extension M&A
• Strategy: To expand into server virtualization market
• Acquisition details:
  – Veritas:
    • Acquisition of VMware did not happen
    • Needed another option to enter server virtualization market
    • Part of plan to develop Utility Computing product suite
  – Ejacent:
    • Based in Redwood City, CA
    • Provided Live Migration of Application instances
    • Acquired for ~$60M in 2004
• Technology Feasibility Analysis
  – Solution required core Operating System changes. Ejacent partnered with Sun as a small company. Veritas did not have a proprietary operating system to leverage. This was a known risk at acquisition, but they thought they could eliminate this dependency
• Final Outcome
  – Killed product line in 2007/2008

Symantec acquisition of Relicore & Jareva – Product Extension M&A
• Strategy: To enter Utility Computing market
• Relicore Acquisition details:
  – Based in Burlington, MA
  – Delivered data center configuration management software
  – Competitors: Opsware, BladeLogic
  – Revenues, acquisition price: not disclosed, acquired in 2006
• Jareva Acquisition details:
  – Based in Sunnyvale, CA
  – Delivered Provisioning software
  – Competitors: BladeLogic, Platespin, IBM Tivoli
• Acquisition was a failure due to following reasons:
  – Integration Plan
    • Aimed to build an integrated solution to address Data Center Automation – to include Relicore, Jareva and Invio (a workflow engine) products
    • Market expected to grow to $11B by end of 2010
  – Integration Issues
    • None of existing products were leveraged, started to build a new product. Starved all existing products and related customer use-cases, which lead to unhappy customers. Needed to pivot integrated solution on the most successful of existing products
    • Failed to assign a strong leader until too late in the plans. This engendered cultural conflicts and architectural conflicts
    • Competitors (Opsware, BladeLogic) moved ahead, making it impossible to catch up
    • Geographical distance did not help – Relicore based in MA, Jareva based in Mountain View, CA
    • Business not aligned with Symantec (who bought Veritas) core domain of security software. This led to a change in strategy for Data Center automation product line
  – Final Outcome
    • Strong leader chosen to lead the integration effort, product close to beta when shelved in 2008
Symantec acquisition of Vontu – Product Extension M&A

- Strategy: To enter Data Loss Prevention market
- Vontu Acquisition details:
  - Based in San Francisco, CA
  - Delivered Data Loss Prevention software, which had synergy with Symantec’s end point and network security solutions
  - Competitors: WebSense, EMC, Raytheon
  - Revenues: ~30M per year, acquisition: $350M in 2007
- Integration Plan
  - To leave Vontu as its own division and help it grow
- Integration success
  - Symantec had OEM-ed Vontu’s software prior to acquisition, so product sales feasibility risk low
  - Division left to run as a stand-alone. No forced sales group integration. Symantec invested more into Vontu’s sales and marketing
  - Business aligned well with parent company’s portfolio
  - Geographical proximity helped: Vontu based in SFO
- Outcome
  - Vontu continues to grow in a healthy manner, has become a core business for Symantec

Yahoo Acquisition of Flickr – Market Extension M&A

- Strategy
  - Improving the existing business model
  - Gain competitive advantage by transferring skills and sharing activities
- Merger Details:
  - Flickr, an online photo-sharing site, launched in 2004. Yahoo! acquired Flickr in March 2005 for $35M. Yahoo! had been developing its image-sharing product before 2004, but fell behind Flickr in 2005.
  - Flickr had 270,000 users, four million photos, 30 percent monthly growth in users, and 50 percent monthly growth in photos in February 2005, and 784K UV in April 2005.
- Post M&A Integration and Outcome
  - Kept the Flickr as a separate brand, and merged Flickr team into Yahoo!
  - Focused on integrating with Yahoo! Image search, but slowed down new product features development (social and community).
  - Both unique user and page view increased after the acquisition. Flickr had 40 billion UV in 2009.
  - Did not achieve the M&A goal to differentiate Yahoo! Image search from Google
  - Both Flickr founders left Yahoo! in 2008 due to cultural differences and business and product priority.
  - Lost the market leadership to the new comers, such as Instagram.

EMC Acquisition of VMWare – Market Extension M&A

- Strategy
  - Acquiring the disruptive business model -- visualization technology, and entering a new market
  - Meet the three tests (attractive, cost-of-entry, and better-off test)
- Merger Details:
  - EMC acquired VMWare in January 2004 for $600M.
  - VMWare had $100M revenue and 300 employees at that time.
- Post M&A Integration and Outcome
EMC kept VMWare management unchanged and operated it as a separate business but provided the financial funding to fuel VMWare growth. The merger did benefit the sharing activities – sale, distribution, and general administration.

VMWare continue big growth with 2006 $387M revenue, 2007 $709M revenue, 2008 $1.3B revenue, and increased payroll to 3000 employees by 2007.

VMWare made its IPO in August 2007. The sale of 33 million shares raised $957M with a market cap of $11M at $29 a share. The founder left VMWare on 2008.

Oracle Acquisition of PeopleSoft – Customer Base Expansion M&A

- **Strategy**
  - Oracle wanted to tap into new growth businesses by acquiring PeopleSoft
  - Oracle wanted to target PeopleSoft’s customers, who were using databases of IBM and Microsoft, and sell them its own database products.
  - Oracle had earlier considered the takeover of companies like BEA9, Siebel Systems10 and Business Objects
  - PeopleSoft had over 12,750 customers in more than 150 countries
  - With PeopleSoft’s acquisition, Oracle could double its customer base and become the largest applications vendor in the US
  - It could also become strong in segments like healthcare and government as PeopleSoft had numerous customers in these segments

- **Merger Details:**
  - On June 6, 2003, Oracle announced its bid to acquire PeopleSoft for $16 per share or approximately $5.1 billion in cash
  - The offer was made just four days after PeopleSoft had announced its decision to buy JD Edwards for $1.7 billion in stock
  - On June 12, PeopleSoft rejected Oracle's offer and filed a suit in a Californian state court, accusing Oracle of damaging its business and sought $1 billion in damages
  - June 18, Oracle raised its bid to $19.50 per share or about $6.2 billion
  - Two days later, PeopleSoft again rejected the offer
  - On June 30, the US Department of Justice began investigations into the Oracle offer
  - On July 18, PeopleSoft completed its acquisition of JD Edwards
  - On January 07, 2005, Oracle Corporation, the second largest software company in the world, announced that it would acquire PeopleSoft Inc. at $10.3 billion

- **Integration**
  - Oracle pursued a few initiatives on the workforce, customer support, and product integration fronts:
    - It would reduce its combined workforce by 10-12 percent
    - Oracle promised that it would provide customer support for both the PeopleSoft and JD Edwards’ product lines till 2013.
    - The company had retained 90 percent of PeopleSoft’s development and round-the-clock support for PeopleSoft Enterprise, JD Edwards EnterpriseOne, and JD Edwards World products
    - Oracle also promised to support its rival database technologies, including IBM’s DB2, Microsoft’s SQL Server as well as the middleware from IBM and BEA
  - In its efforts to integrate the products successfully, Oracle launched “Project Fusion.”
    - It would be based on an architecture that would be modularized for flexible deployment, better performance, and easy maintenance
    - In the long term, Oracle planned to transfer various functions to its own E-Business Suite 11i, making it a more advanced set of applications.

- **Post M&A Integration and Outcome**
Oracle managed to retain 90% of PeopleSoft customers by extending support for PeopleSoft product line till 2013. Oracle even introduced a newer version of PeopleSoft after 2 years of its acquisition.

Oracle started a new product called “Oracle Fusion” which was a best of class combination of all its acquisitions (PeopleSoft, Siebel, BEA Weblogic, Hyperion).

Oracle was successful in increasing its user base. By 2008 its annual revenue grew to $22B – it doubled in 3 years after PeopleSoft acquisition. It did continue with its growth strategy by acquiring competitors.
## Part D: Key Factors for Successful M&A

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Part E: Conclusions

From the above case studies, we present our insights into the key factors for a successful M&A. There are three factors that strongly influence the outcome of a merger:

a) Alignment of merger strategy & integration
b) Alignment of technologies/products of merging companies
c) People factor

Strategy & Integration
- As two companies merge, both companies/employees need to be aware of the reasons behind the merger. Whatever they do during the integration process should be aligned with the strategic goals set during the strategy phase.
- Integration cannot be a part-time job, but rather must be a full-time job for many people in both merging organizations.
- Strong leaders have to emerge from both sides to carry through the integration and hold the merged company together.
- Companies need to decide if they truly want to merge the two companies or leave them alone. This must be a strategic decision and not a tactical one.

Technology/Product Alignment
- The product portfolio of the merged company needs to be carefully stitched together. The merged company must consolidate product lines which may require moving customers from one product line to another.
- Successful mergers cause the least disruption to the customer base. Maintaining a slow transition to phase out products is a good way to transition customers. Showing the combined roadmap to customers and preparing them is a key to the transition.

People factor
- Culture fit – Culture is the set of “unwritten rules” of a company. The unwritten rules of the two companies have to match reasonably well for the merger to be successful. Merging companies should spend time understanding each other’s cultures. This is a critical factor.
- Talent retention – Retaining key talent is paramount for continued excellence of the merged companies. People leave before they feel they cannot contribute effectively in the new organization or it is no longer “fun.”
- Proximity – Physical proximity is another factor for a successful M&A. Close proximity enables employees from each company to interact closely and create a new culture for the new company.

In the M&A process, the two phases are very critical to the success of the process - (a) Deep Due Diligence and (b) Integration. Teams have to spend considerable amount of time during these two phases to ensure the success of the deal.
Part F: References

[1] Competitive Advantage and Corporate Strategy (Diversification) – Michael E. Porter’s paper
Biographies

Amit Agarwal is a Senior Director of Corporate Application at Yahoo. He leads a team of engineers building business systems for Marketing and Customer Experience unit at Yahoo. In addition, he also leads a team of database and application administrators providing system operations support for all corporate business systems. He is transforming Customer Care process and systems by improving critical customer satisfaction and resolution rate metrics. He has over 15 years of experience in implementing global ERP, CRM and data warehousing solutions. Prior to this position at Yahoo, he has worked at Lucent and VeriSign implementing global solutions. Amit holds a bachelor’s degree in Physics from Punjab University.

Robert Hefty is a Director of Business Development at Lam Research. In this role, he is responsible for the business performance of the company across all product lines for a number of Tier 1 customers. Over the past 8 years at Lam, he has had positions of increasing responsibility in the etch product group solving critical problems in productivity & product support, applications development, and as the Customer Technology Manager for various customer accounts. After serving as the Technical Director in support of several of Lam’s logic & foundry customers, he has transitioned to his current role in Business Development. In his spare time, Bob strives to continue to be a catalyst for entrepreneurship, with an interest in creating and building new business. He was the 1998 Big West Student Athlete of the Year for UCSB where he received his bachelor’s degree and has a Ph.D. from the Massachusetts Institute of Technology in physical chemistry.

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Eric Zhao is a Sr. Director of Engineering at Yahoo!, and leads the engineering teams of developing Yahoo! web search. He has been working on search technology for over 6 years, including R&D projects in web search engine, relevancy ranking, content classification, document clustering, natural language processing, and personalization system. Before joining Yahoo!, he worked as a developer, research scientist, architect, and manager in various Silicon Valley companies. Recently, he becomes very interested in developing innovative and successful products enabled by creative technology and best-of-breed software engineering process.