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point*of*VIEW

EXECUTING A SUCCESSFUL MERGER OR ACQUISITION:

DO NOT UNDERESTIMATE THE IMPORTANCE
OF ERP SYSTEM INTEGRATION

BUSINESS
CONSULTANTS

DEEP
TECHNOLOGISTS

VARIOUS MARKET FORCES have combined to drive a growing volume of merger and acquisition activity in recent years. Many deals fail, however, often due to inadequate execution of the integration strategy.

Strategic transaction objectives should always guide the integration strategy, including decisions about and design of the key business systems that will run the organization(s) going forward. Enterprise resource planning (ERP) systems are critical to the operations of all businesses and should receive explicit focus during integration planning and execution as they can make or break the ability to deliver on the deal's intended value.

Given the array of ERP options that exist in today's marketplace, including evolving cloud-based applications, buyers and/or merging organizations should devote special focus to the ideal business and ERP integration strategy for each unique situation.



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This paper examines some common strategic drivers for mergers and acquisitions and the importance of keeping those at the forefront of the integration—particularly when developing and integrating ERP strategies for the organization(s) going forward.

Growing deal volume, but still a high risk of failure

Global merger and acquisition deal volume increased in 2015 for the third consecutive year, surpassing \$5 trillion¹ for the first time. Several factors have fueled the increase, including a combination of low interest rates, large cash reserves amassed during the recession, and improving market conditions.

But even as merger and acquisition deals play a more central role in driving strategic growth, deal failure rates remain extremely high—as high as 70 to 90 percent, according to some studies². The reasons, of course, are numerous. Sometimes, companies overestimate the value to be achieved during early phases of the deal. Other times, they fail to deliver on a deal’s potential during post-close integration. In many cases, realizing a deal’s full potential depends on how, and how well, the companies integrate their backbone systems—the enterprise resource planning (ERP) applications that run their core operations.

Deal strategy sets the tone for enterprise systems

The acquisition’s business strategy and objectives should be the primary drivers for the type and level of integration effort and should define the enterprise systems that receive critical focus during integration. The table on the following page outlines several prominent strategies that drive merger and acquisition deals.

In most cases, the ERP system is the “nervous system” for the merged business and critical to a successful integration. But it also is typically the most complex and expensive component of the integration process. A structured approach (Figure 1) that addresses strategy, planning, implementation and sustainable results is highly advisable and valuable for keeping complex ERP integration and initiatives on track and aligned with the acquisition strategy. At each of these stages, it is important to approach decisions from the multiple perspectives of people, process, and technology.

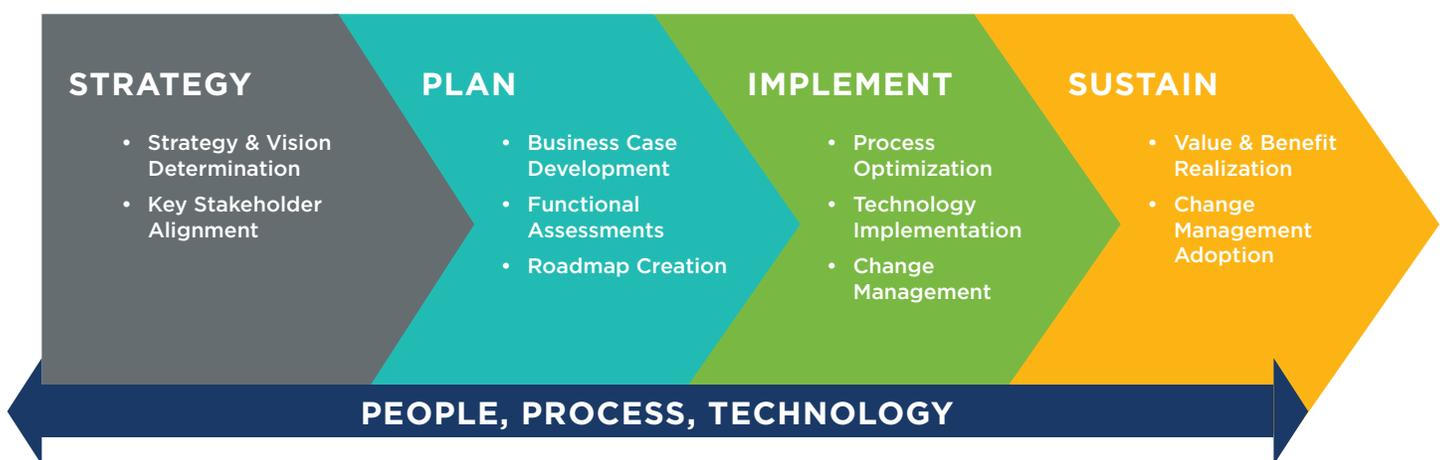


FIGURE 1: A STRUCTURED APPROACH TO ERP INTEGRATION

EXAMPLES OF MERGER AND ACQUISITION STRATEGIES

TYPE OF MERGER OR ACQUISITION	BENEFITS/GOALS	EXAMPLE
Direct competitor/company with the same or similar product line(s); also known as a horizontal acquisition	Eliminates competition; increases market share, revenues, and profits; creates economies of scale; increases cost efficiency	Pfizer's acquisition of Hospira; both are in the sterile injectable drug and technology industry, and the combination created the largest company in that industry
A company in the same business but with operations or strengths in different geography	Allows growth strategically into a new geographic area in which the buyer did not have presence or stronghold	Merger of US Airways and American Airlines; the merger combined their respective geographic strengths and increased market reach
A company whose offerings can provide innovation and new features for an existing product line	Enhance current products or product lines without having to develop new in-house capabilities	Apple's 2011 acquisition of Siri, a voice-controlled application that acts as a personal assistant and navigator; it has since become a key feature of Apple's iOS
A company with similar products but targeted toward different customer segments	Expands the current business into new market segments with similar interests	Adidas's acquisition of Reebok; the companies had similar products targeted to different segments (Adidas focused on sports performance, with sports-star endorsements; Reebok had strong presence in emerging fitness trends and significant non-sport celebrity endorsements)
A company with a different product line targeted to the acquirer's existing customer segments	Introduce new products and grow relationships with existing customer base without developing the required expertise or experience	Google's purchase of Nest Labs, maker of Learning Thermostat, Protect Smoke, and a carbon monoxide detector; this allowed Google to offer smart-home systems to its technology-savvy customers

Several areas often warrant specific discussion during technical integration of ERP applications:

The business case, or potential return on investment: Traditionally, the “hard-number” components of return on investment in ERP integration include organization realignment, inventory reductions, and reduced cost of IT due to consolidation. But there are other “softer” measures that can lead to tangible savings. These include streamlining key processes, customer interaction benefits, optimization of manufacturing capacity, and reduction of duplicative entry and associated errors.

Status and age of technology systems in place: Buyers need to understand the size and magnitude of acquired company’s “technology deficit.” Often, financial and IT officers boast of savings on software maintenance by deferring upgrades and, in many cases, cancelling software maintenance altogether. While this can save money in the short term, outcomes such as unsupported hardware and operating systems can cost an organization much more in the longer term. It is also more difficult to find qualified resources willing to work on old and antiquated technology. Most importantly, lack of maintenance typically correlates with a higher degree of difficulty when integrating systems (Figure 2).

Asking these key questions can help assess the magnitude of a company’s “technology deficit”:

- Does the organization view technology as an asset or a necessary evil?
- How current is the ERP environment? Has it kept up with version upgrades?

- Is the company still under maintenance contract(s) for its key applications?
- How much customization has been performed?
- Are there “key-man” risks in the technology team (i.e., overdependence on particular individuals, for whom no back-up is present if those individuals leave)?

All too often, companies place insufficient focus on the business case for their business applications and lose sight of key acquisition integration objectives. It is important to consider ongoing maintenance requirements necessary for realizing value and benefits over time (i.e., the SUSTAIN part of the structured approach outlined above, on page 3).

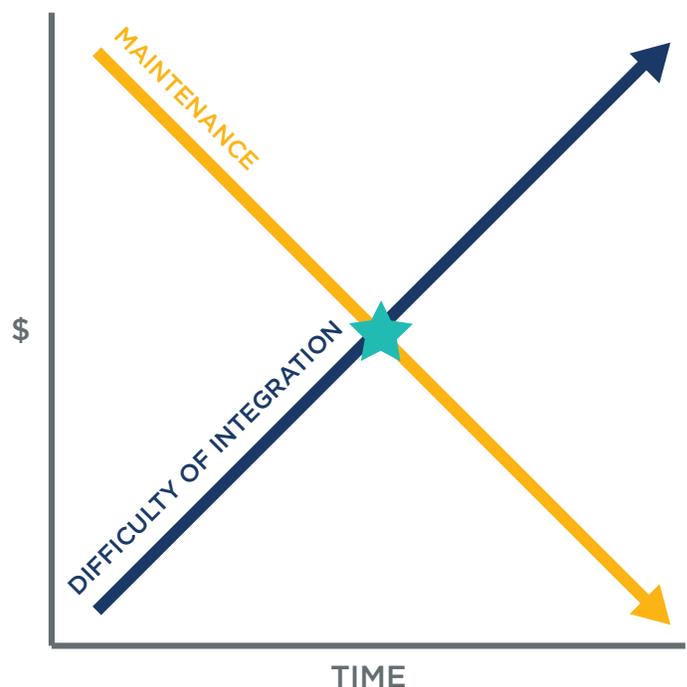


FIGURE 2: LACK OF ONGOING MAINTENANCE OFTEN MEANS MORE DIFFICULT INTEGRATION

Designing your “electronic building”

You would not spend millions of dollars on a new building without careful thought as to its purpose, design, and functionality. Think of the ERP system as the “electronic building” that supports the entire business. When it comes to designing an ERP environment and strategy, there usually are several viable options and no clear “right answer.” Some of the important considerations for setting up an ERP environment following a merger or acquisition will include:

- Business model(s)
- Similarity of the companies in the portfolio
- Portfolio strategy
- Growth plan
- Integration strategy
- Timeframe
- Reporting requirements
- Legal and regulatory requirements
- Desire for uniform and shared services and processes
- Budget

Following are three basic ERP strategies often applied in merger/acquisition or portfolio restructuring scenarios. It is important to note that permutations exist for each strategy.

1| Portfolio companies operate as separate, independent entities:

In this scenario, a parent or holding company owns all of the portfolio companies (Figure 3). An example of this operating model is Berkshire Hathaway. Each company operates independently and has its own ERP system. These could be separate platforms or separate instances of the same platform with no data shared between the companies. To report on the financial position of the portfolio as a whole, each portfolio company must reports its financial positions to the holding company, and the holding company needs a tool, ranging from Microsoft Excel to financial consolidation applications such as Hyperion, Tagetic, Defacto, or Adaptive Planning, in order to consolidate the portfolio companies’ financial data. This strategy provides the most autonomy at the portfolio company level. However, from the holding company’s perspective, it is more difficult to monitor and control cash inputs and outputs. It also can limit synergy opportunities across the portfolio.



FIGURE 3: HOLDING COMPANY WITH INDEPENDENTLY OPERATING PORTFOLIO COMPANIES

2 | Portfolio companies do business as separate companies but share certain business functions across the portfolio (e.g., Mattel):

Opportunities for sharing services across portfolio companies may include purchasing/procurement, customer relationship management and sales orders, human resources, information technology, or other functions. This strategy can help maximize portfolio profitability by reducing duplicative functions and tasks, achieving economies of scale with respect to discounts, and taking advantage of product and service cross-selling opportunities. Depending on the level of shared services, the holding company may implement a separate ERP system for shared services and leave legacy ERP systems in place at the portfolio-company level

(Figure 4). Shared services, however, can be difficult to perform with inputs from disparate systems and processes. When shared functions use one system and the portfolio companies use other systems, this may require additional processes (and cost) to handle the various inputs from each different portfolio company. The holding company may require customization or integration applications/tools to execute shared services effectively. On the other hand, this model provides the parent company with more control and greater visibility into day-to-day operations and cash inputs and outputs of the shared functions.

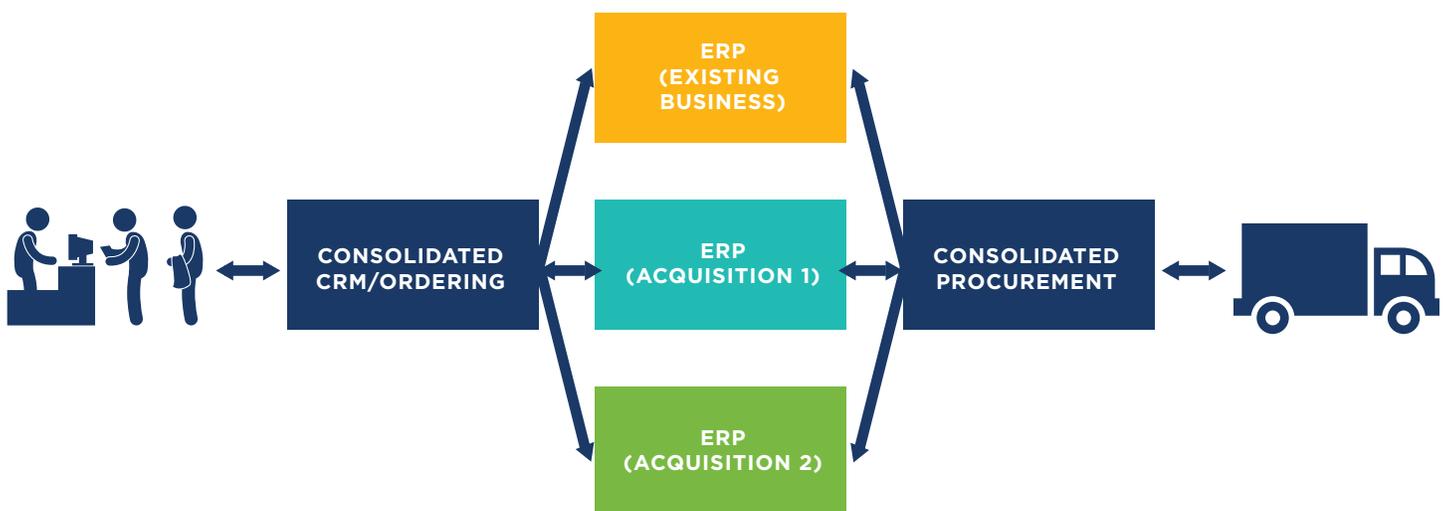


FIGURE 4: PORTFOLIO COMPANIES RETAIN THEIR OWN ERP SYSTEMS, BUT THE PARENT USES A COMMON APPLICATION FOR CERTAIN FUNCTIONS SUCH AS CUSTOMER RELATIONSHIP MANAGEMENT AND PROCUREMENT

3| Portfolio companies are fully integrated and operate as one company (e.g., United Airlines):

In this scenario, the company utilizes one ERP system to house data from and manage operations of all aspects of the business. This model makes reporting and monitoring much easier and provides the parent company with full control over day-to-day activities, but it takes longer to integrate portfolio companies than other options. Change management is extremely important, as this type of transformation can be extremely disruptive to day-to-day operations. It is particularly valuable to consider the “to be” processes (Figure 5) rather than just working with what exists today, in order to capitalize on the plentiful consolidation and synergy cost-saving opportunities.

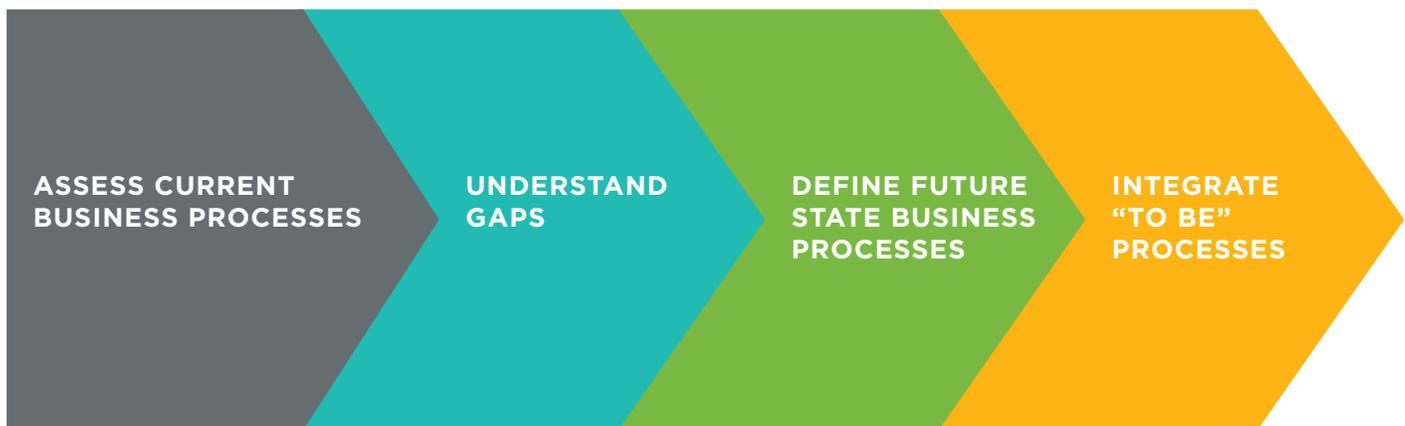


FIGURE 5: WHEN CONSOLIDATING COMPANIES ON ONE ERP SOLUTION, GIVE EXTRA CONSIDERATION TO THE WAY THE INTEGRATED COMPANY “SHOULD” OPERATE

Navigating the ERP landscape

The integration strategy chosen will have a direct impact on ERP system requirements. Organization leaders will need to address a host of questions and ultimately decide between the many available ERP system alternatives (Figure 6):

- **Application type:** Best-of-breed (point solutions for each function) versus best-of-suite (one solution for all functions)
- **Application hardware:** On-premise (owned, maintained and housed on-site) versus cloud (owned, maintained, and housed off-site) versus hosted (owned by the organization but maintained and housed off site)
- **Application software:** there is a broad range of application offerings that can fit based on the size and complexity of your business and your desired future state business model

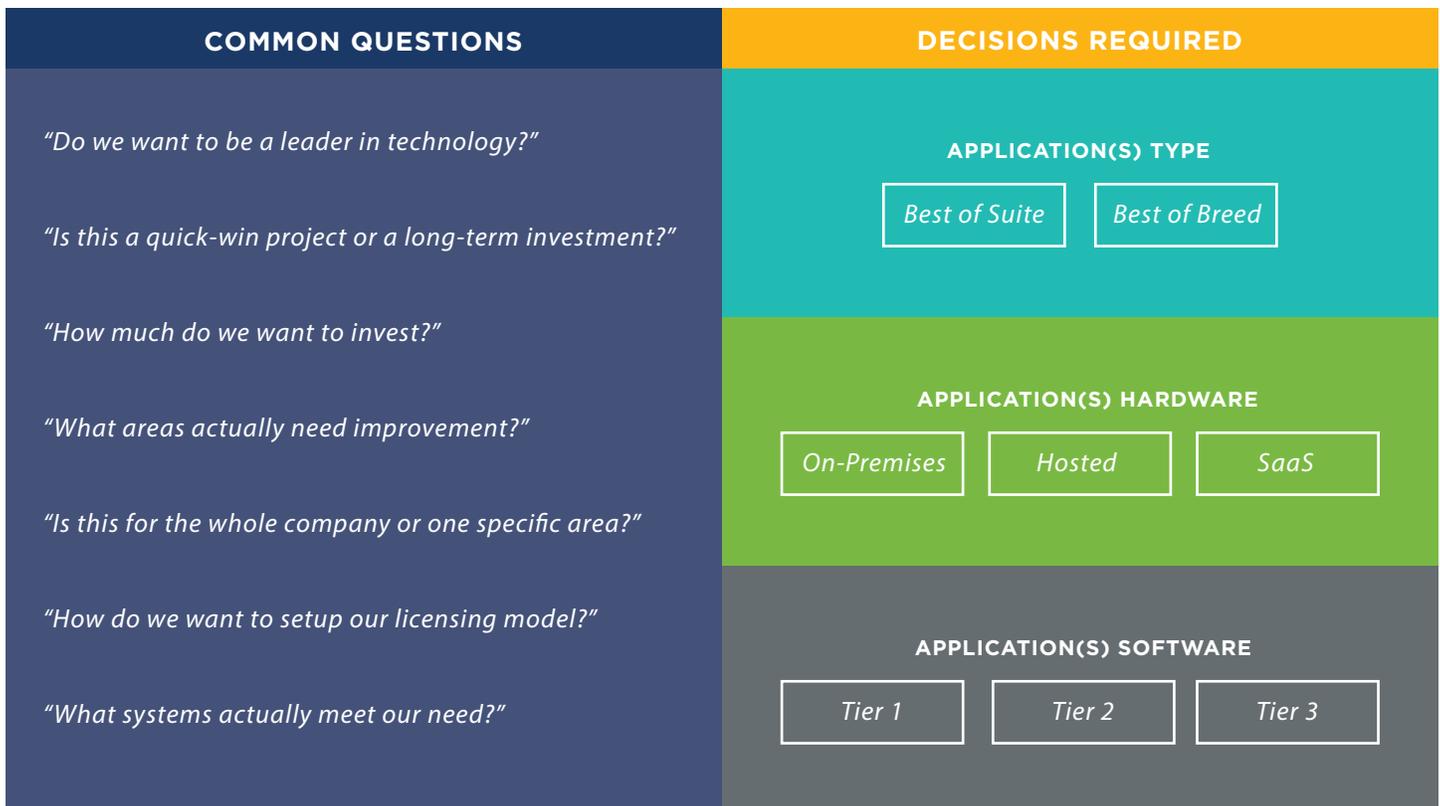


FIGURE 6: COMMON ERP QUESTIONS AND DECISIONS IN A MERGER OR ACQUISITION

With the advent and evolution of the cloud, the number of ERP technologies available to support and enable integration of two businesses has increased significantly (Figure 7 below, on the following page depicts some but by no means all available ERP solutions). Cloud-based ERP options have become increasingly configurable, faster to deploy, and specific to the needs and requirements of certain industries (for example, NetSuite for Professional Services or Plex for Manufacturing).

Often, a hybrid approach that utilizes multiple solutions is the best answer for the merged organization—and, in this case, integration of the two ERP solutions also becomes critical to successful business integration. It is also important to leverage commercially available integration tools such as Dell Boomi, Informatica, or Jitterbit to facilitate rather than “rolling your own solution” that could be prone to error, difficult to scale, or restricted to certain coding languages.

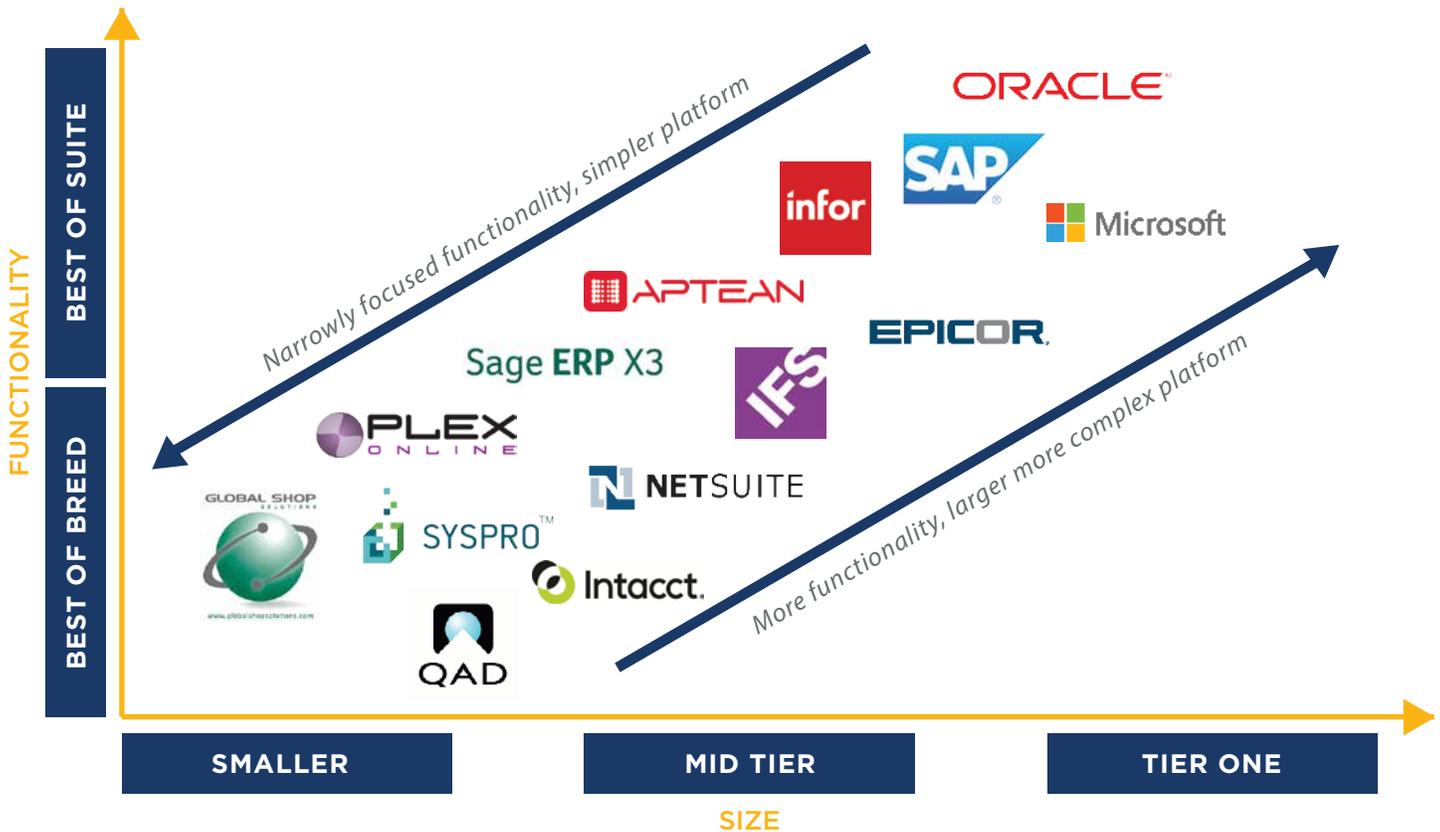


FIGURE 7: A SAMPLING OF SOLUTIONS IN THE ERP LANDSCAPE

ALIGN YOUR ERP STRATEGY WITH YOUR INTEGRATION STRATEGY

During the diligence process, it is critical that you have thought through your ERP strategy and how it will impact your overall integration strategy. Pay particular attention to the synergies you are looking to attain as a result of the merger or acquisition and make sure you include adequate time and budget to plan and execute your ERP and business integration strategy.

These are critical business strategy questions—and all of them hinge on your ERP strategy and integration decisions. In many cases, these decisions prove to be the key to a successful—or a failed—merger or acquisition. So proceed with care and do not forget your ERP systems.



SOURCES

¹ <http://www.dealogic.com/media/market-insights/ma-statshot/>

² <https://hbr.org/2011/03/the-big-idea-the-new-ma-playbook>

About West Monroe Partners

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