

TRAINING FOR THE M&A MARATHON

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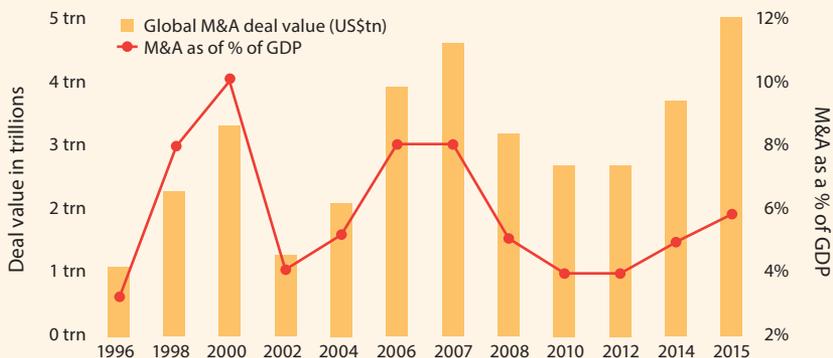
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A few years ago, two airlines announced a merger they said would bring tremendous synergies and increases in flights for customers. With a doubling of flights, the extra coverage came quickly, but the synergies did not. That is because they were difficult to secure—crucial decisions on which pricing and other key business systems to choose, how to reduce duplications in business processes and their supporting IT infrastructure, and how to merge staffs. The integration took months longer than the companies expected, and mistakes were made—a superior pricing system was discarded for an inferior one, valuable employees left in droves, and more.

Unfortunately, stories such as this one are still common today. Companies that merge with others are unable to rapidly integrate IT-intensive business processes, systems and functions. They wind up paying a steep cost.

Global M&A activity



Source: J.P. Morgan, Dealogic as of January 8, 2016; M&A as of a % of GDP is rounded to the nearest whole number

To be sure, mergers and acquisitions have always been, and will always be, a powerful tool for companies to get lighter—to generate more revenue at less proportional cost. And the most successful mergers are ones in which the efficiencies happen quickly. The pursuit of such synergies is a core reason why global M&A has continued to race along at a breakneck pace since 2010—from 3% to 6% of global GDP.⁵⁸

It is no surprise then that acquiring companies increasingly are scrutinizing the potential synergies, before and after the acquisition. Those include business processes that are IT intensive and which can be combined (such as online marketing), data centers and IT infrastructure, and the professionals to keep the processes and systems going. Given that information technology spending is one of the single largest categories of costs nowadays, achieving the synergies can do much to improve the bottom line (and sometimes even the top line) in the first year.

⁵⁸ J.P. Morgan Chase and Co., 2016 M&A Global Outlook, accessed July 7, 2016, <https://www.jpmorgan.com/global/insights/maglobaloutlook>

In fact, McKinsey & Company estimates that 50% to 60% of post-merger synergies are related to combining such IT-related activities. In healthcare, it found 15% of synergies come directly from lowering IT infrastructure expenses, reducing IT personnel, and gaining bigger volume discounts from IT suppliers. But in financial services, the prize is even bigger—25% of the synergies can come from combining two companies' IT activities. Another 35% can be achieved from what McKinsey called 'IT-enabled' moves: for example, reducing finance and HR expenses through connecting their systems, cutting logistics costs through optimizing distribution routes, and more cross-selling by integrating customer data.⁵⁹

But doing all this in a short period of time can be a nightmare with unintended consequences. McKinsey's research found most IT-related merger issues were not fully resolved even in the early stages of post-merger planning.

Another study, conducted in 2007, found IT integration to be ignored in four out of five acquisitions. More than a third of the companies surveyed did not think they would integrate the IT functions within two years after their mergers.⁶⁰

This is not at all a surprise to us. Recently, a multibillion dollar electronics company that was about to make several acquisitions turned to us for advice. It was not sure what to do with the IT functions and IT-intensive business processes of those firms, and whether and how to combine them with its own IT staff.

Combining business processes and IT departments post-merger can be fraught with hazards, unless both companies have prepared for it long in advance. It is like training to run a marathon—if you are about to run your first one after only a few of weeks of training, you are unlikely to finish the 26.2 miles. Preparing your organization for a merger—just like preparing for a marathon—requires extensive planning and preparation months before the event begins. This applies to the parties on both sides of the deal.

⁵⁹ McKinsey & Co., Understanding the strategic value of IT in M&A, January 2011, accessed June 24, 2016, <http://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/understanding-the-strategic-value-of-it-in-m-and-38a>

⁶⁰ CIO, Mergers and Acquisitions: What do CIOs Need to Know? January 22, 2008, accessed July 5, 2016, <http://www.cio.com/article/2437291/mergers-acquisitions/mergers-and-acquisitions--what-do-cios-need-to-know-.html>

If you are not prepared, three major problems can ensue:

- Much longer times to generate synergies
- Better business processes, systems, and technologies (typically, those of the company being acquired) being discarded in favor of inferior systems—even when the superior systems provide distinct competitive advantages
- An exodus of highly valuable business process and IT people

This article provides an overview of the preparation that will be necessary for companies that make multiple acquisitions. CIOs of both companies involved in the M&A must understand this process if their systems and staffs are to survive. The two CIOs must thoroughly understand their departments' assets, costs, and performance.

WHY DUE DILIGENCE OFTEN FALLS SHORT

Why are the business process and IT implications of acquisitions too often underappreciated in deal planning? From our experience, it is because the parties responsible for identifying acquisitions (investment bankers) and making them work (management consulting firms) are focused elsewhere. In due diligence, the focus is on two companies' operating models, products/ services, markets, and distribution channels. The finance departments are looking at numbers. Yet all too often, no one is looking closely at IT-intensive business processes and IT operations, and the IT leaders at these companies are rarely involved.

But that is changing now. In fact, some of the best companies at integrating businesses after mergers—private equity firms—are paying close attention to combining IT-intensive business processes and related systems post-acquisition.

Companies that merge IT-intensive processes effectively make IT a core competency of the overall M&A plan, not a muscle that they develop and exercise only when a new deal is at hand.

Rather, they train for M&A as if it is a marathon they will run for the foreseeable future. It enables them to finish the race every time there is a deal, and quickly.

To accomplish this, companies need to possess strong capabilities in evaluating a target acquisition's IT-intensive processes, infrastructure, and business process and IT professionals. And, ironically, they need to have an even stronger understanding of their own capabilities. Otherwise, when asked to make apples-to-apples comparison between their infrastructure and a target companies' infrastructure, they will not know which one is better.

Companies that best integrate their business processes and IT after a merger also possess an overall philosophy about the best ways to manage such operations, especially the steps that make integration faster, less risky and less expensive. Those that do this right can integrate these operations in six months or less, rather than the twelve to eighteen months it often takes.

THE SIX PRACTICES THAT ACCELERATE M&A

From helping a number of companies make such merger integration work, we have found six practices to be crucial.



Building an M&A center of excellence.

Large companies have built centers of excellence (COEs) for many functions and activities—finance, supply chains, and customer support operations. For example, industrial manufacturer 3M has supply chain COEs that help it manufacture and distribute its products in new international markets.⁶¹ Such COEs employ a core staff that works full-time on continually honing their skills and a playbook that defines the elements and steps of their COE's topic focus. Few COEs exist today in big companies for M&A in general, much less the IT-related operations that are merged. But to become highly accomplished at doing it quickly, companies need a COE that continually refines its practices based on the latest acquisitions.



Creating stringent and demanding metrics for synergies.

Time is the great killer of potential synergies—from cost savings, new revenue from cross-selling, and so on. In merging IT-related operations, moving fast is key to getting such benefits. But this means setting an aggressive timetable for deciding which IT-intensive business processes, applications, infrastructure, and personnel to keep for merging the systems and reducing the data center footprint. One global chemical company has conducted studies to determine best practices in M&A integration, especially to understand how fast such operations of two companies can be merged. All this is analogous to the best marathoners—they always pay careful attention to their race times and practice times. Software companies like Oracle and SAP that have made many acquisitions over the years have become skilled at merging other software companies' business processes and systems onto their platforms quickly. Just five years ago, Oracle could integrate most acquisitions in six months or less.⁶²

⁶¹ Nasdaq, 3M's Model for Global Expansion, December 31, 2013, accessed July 2, 2016, <http://www.nasdaq.com/article/3ms-model-for-global-expansion-cm315314>

⁶² McKinsey & Co., Understanding the strategic value of IT in M&A, January 2011, accessed July 3, 2016, <http://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/understanding-the-strategic-value-of-it-in-m-and-38a>

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Intimately knowing your operational infrastructure.

In the merger of

the two airlines mentioned at the beginning of this article, the IT function of the airline that was purchased put itself at a huge disadvantage after the deal closed because it had not thoroughly documented its performance. This was unfortunate because the company had a superior pricing system. But it was not prepared to have a bakeoff with the acquirer for this pricing system—or any other system. The acquirer was known for its cost-driven culture. The acquired company, in contrast, was famous for a culture of service excellence. Shortly after the deal closed, the CEO of the acquirer asked his two CIOs to benchmark their departments' IT performance and evaluate each one's pricing systems. The acquiring company had an inferior system, but because the CIO was well prepared—having done rigorous analyses of his function and its systems, including his pricing system—that system won. Despite having a better system, the acquired company lost out because its CIO could

not answer important questions, such as how many systems would be affected in the merger. An answer of 'hundreds' was not nearly precise enough.

Having an in-depth and documented understanding of a company's infrastructure (business processes, systems, core data, their performance, dependencies on other systems, etc.) alone can save 35% to 40% of the time it takes to integrate two big IT departments. When it is in hand, the analysis—the bake off—should be able to happen in a month. When that data is not there, it can take many months to pull it together. Possessing all the pertinent facts about your infrastructure will greatly reduce the chances that superior systems and people go by the wayside, the victims of political decisions based on whose leader is the superior storyteller.

4**Adhering to a philosophy of standardized enterprise systems and the business processes they support.**

Much has been written in the past for the need for global corporations to implement standard enterprise systems—ERP, CRM, supply chain management, and HR. Yet far too many companies still use a mishmash of enterprise packages or even contort software from the same company in order to please local interests. This is a huge impediment to rapidly integrating IT in a merger. It is much easier to integrate the enterprise systems of a company with a standard Oracle or SAP system than it is to merge five to ten flavors of those systems.

Being prepared for the M&A marathon requires companies to harmonize their own enterprise systems, to fall back on one standard in each business process. Standardizing the way data is collected and formatted, and the way business processes are run, will also go a long way to make integration easier. This also makes documenting and benchmarking your operations far easier. For example, if you have only one sales planning system, and the same version of it across your company, it is much easier to document its performance. With different flavors of the system, or (to be sure) ten different packages altogether, the complexities of evaluating and integrating them just went up by a factor of ten.

5**Maintaining a narrow integration focus.**

A large company can have dozens, even hundreds, of business processes and supporting information systems. But rest assured that they all do not have the same value in keeping customers happy and competitors at bay. Companies that announce shortly after a merger that they will benchmark 100 or more business processes and systems across two organizations are asking for mountains of trouble. That work will require dozens or hundreds of analysts, months of time and lots of money.

Moreover, only a few processes truly matter to a company's marketplace performance. The pricing system of the aforementioned airline company, for example, is what distinguished its financial performance, as well as its customer service. In most companies, 70% to 80% of their processes and systems are commodities—infrastructure that does not distinguish the company. Only 20% to 30% are core to competitive differentiation. During a merger, both parties need to focus their integration efforts on that 20% to 30%.

Being prepared for the M&A marathon requires companies to harmonize their own enterprise systems.

Going back to the airline example, had the acquiring firm focused only on the pricing systems at the outset, it would have had more time to determine whose systems should prevail. But it did not focus on pricing—it evaluated dozens of systems and processes concurrently. The result was a hasty decision that led to choosing the wrong pricing system. The lesson—decide which of your processes and systems are in the core 20% to 30% that really matter, then spend 70% to 80% of your time deciding on how to integrate them.

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Embracing M&A as a fact of life and continuous M&A improvement as a core competency.

Many executives regard the time spent to make a merger work as a negative experience. But for many companies, especially those in mature and fast-consolidating markets, M&A is unavoidable. In these firms, the mindset must change—M&A is a necessity to keep them competitive. At the global chemical company mentioned earlier, the CIO and

his boss recognized the firm had to make a near steady stream of acquisitions and divestitures. That helped their staffs view their M&A activities as a positive and a competence they had to keep improving. That leads to the second point here. After your company has established its M&A center of excellence, it cannot sit back and let that knowledge become static. The world of information technology changes more quickly than most imagine. Better technologies emerge, requiring a fresh look at how they can help a company market, sell, and manufacture its offerings, new business process and IT skills are required, and companies now have many more options in building IT-intensive capabilities. For example, many companies still do not understand the growing capabilities of public clouds as they are still pondering how many servers and other IT infrastructure they will need for their computing workload. More of such infrastructure is becoming available outside your data center. If you are basing your technology budget on an on-premises model, it is likely to become outdated at some point.

ONLY THE HIGHLY PREPARED WIN THE M&A RACE

Experienced marathoners train for race day. After the race is over, they soon begin preparing for the next marathon. Companies that make M&A a key growth strategy need to take the same approach. They need to prepare rigorously for the day when they buy another company and hope to reap the substantial benefits from streamlining their IT-intensive operations. Companies that rise up to this challenge will have a powerful advantage in a world driven by scale and cost advantages.