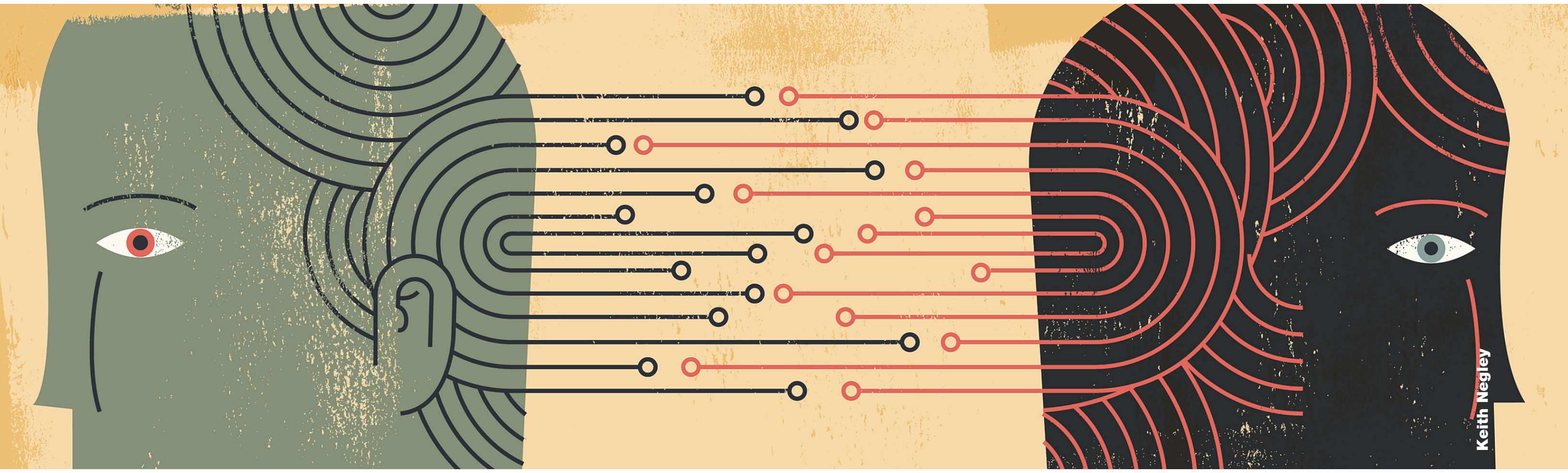
McKinsey Quarterly

JANUARY 2011



BUSINESS TECHNOLOGY OFFICE

Understanding the strategic value of IT in M&A

Many mergers don't live up to expectations, because they stumble on the integration of technology and operations. But a well-planned strategy for IT integration can help mergers succeed.

Hugo Sarrazin and Andy West

With the number of mergers and acquisitions expected to rise over the next few years, many companies are looking for ways to improve their M&A skills—especially their ability to assess and integrate target companies successfully. We've all heard about deals where the stars seemed aligned but synergies remained elusive. In these cases, the acquirer and target may have had complementary strategies and finances, but the integration of technology and operations often proved difficult, usually because it didn't receive adequate consideration during due diligence.

One reason is that executives from IT and operations often aren't included in the due-diligence process, preventing them from offering valuable input on the costs and practical realities of integration. Executives can't hope to forecast the savings from merged supply chains, for example, without a deep understanding of what's required to integrate two companies' information systemes. Too often, this key information is overlooked. In our work on postmerger management, we have found that 50 to 60 percent of the initiatives intended to capture synergies are strongly related to IT, but most IT issues are not fully addressed during due diligence or the early stages of postmerger planning (exhibit).

If a haphazard approach to technology can drain value from an acquisition, the opposite is also true: a company with flexible, streamlined IT—one where executives rationalize systems and make disciplined decisions about integration—can wield this knowledge as a powerful tool in choosing which

Takeaways

IT can be a powerful factor behind M&A success, assuring synergies are realized and ultimately increasing the deal-making capacity of acquirers.

Acquisition-minded companies with flexible, adaptive architectural platforms are less likely to experience postmerger integration difficulties.

IT should have a seat at the due-diligence table to spot potential obstacles to integration such as poor technology at the target company.

A solid postmerger game plan can speed up crucial decisions about which systems need to be maintained and integrated and which should be shut down.

deals are most attractive. Conceivably, acquirers might even be able to bid higher, since they are better prepared to capture the 10 to 15 percent cost savings that successful IT integrations deliver.

Over the past few years, we've identified several leading companies whose M&A strategies have been supported by a flexible IT architecture. These companies capture a broader range of synergies, and at a faster pace, than competitors that fail to consider the challenge of IT integration. As a result, these leaders are more successful at sizing up targets and executing acquisition strategies.

In our experience, these companies do at least three things right when it comes to back-end integration. First, they get their own IT house in the best possible shape before initiating any deals. Many have already adopted advanced, service-oriented architectures (SOA) that are generally more flexible and adaptive, as well as designed to provide a platform that accommodates a wide range of business applications.[1] These companies have also reduced the number of systems—for example, one enterprise-resource-planning (ERP) system rather than multiple instances—and developed a model that considers not only the current company but also new data that may be gained in acquisitions or in moving into new businesses. In short, they have exercised the internal muscles they must have to lead a successful integration. CEOs and CFOs should be wary of embarking on an M&A growth strategy that will require a lot of back-end integration if their corporate IT architectures are still fragmented: the risk of failure is too high.

Second, as these companies begin merger talks, top management makes sure that IT leaders have a seat at the due-diligence table to get their perspective on the difficulty of systems integration. By evaluating the target company's technology, executives can determine how it complements their own IT strategy and operations, including what systems to retain and what data should migrate to the acquiring company's platform. This step is particularly important as companies review cost and revenue synergies. Too often, forecasts are driven by financial formulas or rules of thumb provided by the merger's advisers. In practice, however, many of these calculations depend on a company's ability to integrate IT operations—not just IT itself, but the functions that IT enables, including finance, HR, logistics, and customer relationship management (CRM).

Last, these companies carefully plan postmerger integration, including the role that IT will play and the resources at its disposal. When the acquirer has reshaped its own IT platform, it can rapidly integrate the target company's platform into a carefully considered architecture, enabling data from the acquired company to be migrated in less than six months.

To achieve such an aggressive target, these companies quickly select the platform and data architecture to use and consider other integration details. Resolving these issues removes uncertainty and focuses organizational energy on how to make the transition work. Naturally, this process is easier with smaller acquisitions in a familiar sector, but we have also seen it applied successfully in larger, more complex deals.

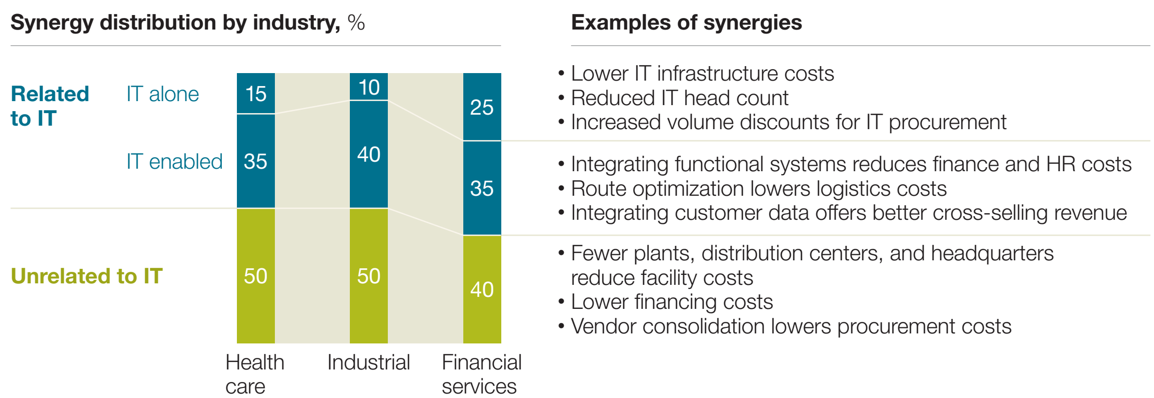
Create a strong acquisition platform

Companies that take a strategic approach to M&A build an information architecture well suited to acquisitions. Consider Oracle, which from 1999 to 2004 consolidated 70 internal systems into a single ERP system for all business functions,

[1] See Janaki Akella, Helge Buckow, and Stéphane Rey, "IT architecture: Cutting costs and complexity," mckinseyquarterly.com, August 2009.

Exhibit

Often, more than half the synergies available in a merger are strongly related to IT.



including sales and finance. This approach saved the company $1 billion annually; more important, it created a platform that supported an ambitious M&A strategy of more than 50 deals from 2005 to 2009. As a result, Oracle can now integrate most acquisitions within six months.

With this capability in place, the CIO can be a strategic partner in *identifying* acquisition opportunities. The further upstream the CIO is involved, the more value can be added. As we have noted, successful M&A depends increasingly on a flexible IT architecture that goes beyond simplifying integration, to strengthen the value created by the acquisition. The IT functions in these companies develop standard processes, tools, and data-management systems to absorb an acquisition more effectively. More important, this discipline will pay off later, when IT leaders need to make tough decisions about integration, including when to leave legacy systems behind and which ones should be migrated to the acquiring company's system.

In this scenario, leaders who demonstrate IT's value in the integration effort to their colleagues in the C-suite can become key figures. CIOs who take on this role understand an acquisition's business goals as well as the steps necessary to achieve them. They're not afraid to commit to time lines and budgets to realize synergies—a move involving some career risk, given the churn rate for IT executives. And they ensure that their IT organizations share this culture, so IT can align quickly and take decisive action in the first 100 days after a deal closes.

At one rapidly growing biotech company, IT and business leaders work closely during the M&A planning stages to ensure that they agree on a merger's strategic goals. Once a deal closes, they collaborate to estimate the time lines, costs, and risks of integration. A few weeks into the merger, IT leaders update the business and receive final approval on resources and plans.

Better communication increases the chances for a merger's—and the CIO's—success. IT leaders who are not included in broader strategic discussions are liable to miss crucial information. One insurance industry CIO mapped out a plan for

Key questions for Day One

If you answer yes to any of these questions, there's room for improvement to smooth postmerger integration efforts.

1 Applications and technology architecture
Do you rely heavily on custom or proprietary technologies?

2 IT infrastructure
Do you have many small data centers in expensive locations?

3 Labor productivity
Are your processes different in different locations?

4 Sourcing
Are many small vendors providing materials that could be sourced from fewer, larger vendors?

5 Demand management
Do business leaders fail to prioritize IT needs and assert that "everything is important"?

6 Organization and governance
Does IT management spend a lot of time putting out fires?

an 18-month IT integration but failed to devote sufficient resources to a new product line that the business leaders wanted to launch in the first year of the merged organization. When the business decided to proceed, the CIO had to deliver the bad news that the resources weren't available to support the new products without shifting the time line for the rest of the integration.

Be a player during due diligence

As companies begin to plan an acquisition, IT must have a seat at the due-diligence table. The technology team can spot potential obstacles to integration in the acquisition target (for example, incompatible platforms that will require a workaround) or identify potential liabilities (such as the massive underinvestment in technology we often see at target companies, which results in a postmerger IT function that depends on outdated architecture and systems).

A waste-management company, for instance, has adopted an aggressive M&A growth strategy that adheres to these practices. Its IT team insists on broad access to the target company's IT, including documentation on architecture and systems, as well as interviews with key personnel. As the deal progresses, access increases; in some cases, reviewers must sign nondisclosure or noncompete agreements with the target before reviewing IT systems.

IT members on the integration team should also gauge the target company's in-house and outsourced capabilities, verify whether a shared-service model is in place, and determine how to retain the best talent. The acquirer might want to offer monetary bonuses to keep employees through the integration, to prevent a mass exodus that would impair the new organization's ability to operate.

As organizations depend increasingly on the information systems that coordinate transactions, manage operations, and aid the pursuit of new market opportunities, the role of technology in mergers becomes more critical.

The failure to identify gaps in talent can delay integration or force a company to bring in expensive vendor resources. Both have a negative effect on deal synergies.

Once the acquiring company has assessed the target's technology, IT can help identify opportunities and estimate the costs associated with realizing them. By working with functional subteams, IT can understand the true impact of integration and form realistic estimates of its duration. In a recent industrial merger, for example, IT collaborated with all functions during integration planning to design a critical order-to-cash system that served several businesses. As a result, each line manager could clearly identify not only the processes that would be implemented once the merger closed but also the timing and eventual magnitude of the improvements.

Hit the ground running

Beyond due diligence, the real work of integration begins well before a deal closes, so that the merged organization can be operational on Day One. Serial acquirers develop a clear strategy for determining which data to migrate and which systems to keep in place for a while. Financial and employee systems such as payroll and benefits, critical to keep the business running and ensure regulatory compliance, are often ported over to the acquirer's system. The organization can then pursue the key objectives of the acquisition.

One resource-management company typically begins by integrating logistics and routing systems, which are crucial to supporting its facility-management operations. Business leaders can then move on to the acquired company's other systems to ensure they are fully integrated within the agreed time line (see sidebar, "Key questions for Day One").

Day 100 is a key deadline. By then, the organization will have completed its first quarter as a combined entity, a milestone that generally involves coordinated financial and other regulatory reporting. To support these tasks, best-practice teams agree to make decisions quickly, understanding that the swift integration of IT systems is more valuable than a lengthy debate on the relative merits of competing systems. Typically, the acquiring company can migrate data and systems to its own platform in less time. In a horizontal integration, where the newly acquired company's markets expand on existing ones, this is particularly true.

In some cases, it makes sense to hold on to a target company's legacy systems. A financial institution's CRM systems, for example, may be closely tied to the new markets and customer bases that represent a significant chunk of a deal's value.

Trying to integrate those systems into existing ones geared to different types of customers could be too disruptive. In some vertical integrations, systems may support different levels of the value chain, so it might make sense to keep these systems on existing platforms to avoid disruption while IT, operations, and finance develop a longer-term, comprehensive integration plan. Successful IT departments embrace the concept of flexibility, adopting temporary work-arounds when they make business sense. In a recent merger of two technology companies, for example, the acquiring company's CIO collaborated with the sales force to provide an accurate projection of when an invoicing system would come on line. This insight enabled management to invest in a critical interim IT work-around that supported significant cross-selling opportunities, instead of waiting several months for a new solution.

• • •

As organizations depend increasingly on the information systems that coordinate transactions, manage operations, and aid the pursuit of new market opportunities, the role of technology in mergers becomes more critical. Companies with a keen understanding of IT's essential role in M&A can gain an edge in completing successful mergers. CIOs who clearly articulate this opportunity to fellow senior executives should earn a more strategic role in M&A.

Hugo Sarrazin (Hugo_Sarrazin@McKinsey.com) is a director in McKinsey's Silicon Valley office, and **Andy West** (Andy_West@McKinsey.com) is a principal in the Boston office. Copyright © 2010 McKinsey & Company. All rights reserved.