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The Hidden Demon

How IT Foils Acquisition Success

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Justification for the price premium of acquisitions is typically the cost savings, productivity increase, customer service improvements, and other synergies that should result from the combination. Time and again, however, the opposite happens: cost savings are elusive, customer service declines, and confused employees lose productivity. The hidden demon causing this loss of value is often IT. Executives expect benefits to accrue as a result of the assimilation of the two companies' systems and processes. But incompatible technology foundations, a patchwork of undisciplined IT-enabled business processes, and redundant databases confound efforts to truly merge the two companies.

Yet some companies we have seen in our research and professional experience are able to quickly and successfully integrate IT after an acquisition.[1] Surprisingly, these companies have not necessarily selected the best IT systems – in fact some are making do (quite well) with outdated legacy systems. What sets these companies apart is that they have carefully designed their business processes, decided how standardized they want them to be, then automated them using IT. Companies that are good at post-merger integration – for example TD BankNorth, CEMEX, and MetLife – have done much more than simply select good IT systems. These companies have carefully designed how they interact with customers, manage products, and work with suppliers and other partners. And before doing any acquisition they decide to what degree their business processes will be made standard across countries and businesses, and where flexibility is needed.

The lesson to take from these companies is: if you're considering an acquisition, the most important due diligence you can do is on yourself! How do you do business? How are your internal business processes and IT systems structured and connected? If you're planning on installing your systems in the acquired company, do they have the flexibility they need? There are four approaches to post-merger IT integration, and the answer to these questions will determine which of the four you can use and how easy it will be to execute.

The four approaches to post-merger IT integration

To integrate a new acquisition you have four choices:

- rip out and replace systems,
- selectively standardize systems,
- connect and coordinate systems,
- operate systems independently.

Each approach offers different benefits and presents different challenges. In the first approach, you strictly implement one standard way of doing business around the company. The second also has a strong degree of standardization, but allows modular additions of unique functionality to support local differences. In the third, the company's IT and operations are largely kept separate, but a single point of contact with customers, suppliers, or other external parties is created. The last approach leaves the two companies as separate entities.

The Rip and Replace Approach

The Rip and Replace approach is used when the acquisition is intended to expand the geographic reach of current products. It's usually justified through operational improvements and cost reductions. If

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the strategic logic for the acquisition is expansion into new product areas, the changes needed to IT systems make this integration approach unworkable.

With this approach, don't stop to analyze the relative merits of the systems and processes of the acquired company. Just rip out the target company's systems and business processes, and replace them with yours. TD BankNorth, rated by Fortune as one of the best managed banks in the US, has nearly doubled in size between 2002 and 2006 as a result of the acquisition of 12 regional banks. In each case they have ripped out the acquired bank's systems and installed their corporate standard system, raising the performance of the acquired bank and expanding their market footprint. Similarly, CEMEX, the Mexican cement company has grown to become the most profitable of the world's large cement companies through a Rip and Replace approach to integrating acquisitions.

CEMEX's approach to Rip and Replace is to install in each acquisition the technology and standardized systems supporting eight key processes: commercial (customer facing and cement logistics), ready mix manufacturing, accounting, planning and budgeting, operations, procurement, finance, and HR. Using this approach in 2000 CEMEX completed assimilation of its $2.8 billion acquisition of Southdown, the U.S.'s second largest cement manufacturer, in just four months. Subsequent acquisitions have been assimilated in as little as 2 months.

Inevitably, the approach will meet with resistance from the acquired company's employees. So, CEMEX invests heavily in training, sending in teams of strong managers who work with the new company's management team. CEMEX management has also created an IT and Business Process Evolution organization to encourage local innovation even as it attempts to standardize and share global best practice. With strong performance results, and appropriate rewards, the resistance subsides and enthusiasm builds.

But we have seen many examples of failed Rip and Replace efforts. In the telecommunications industry, we saw two acquisitions that targeted operational improvements, but generated no such synergies. The complexity and variety of the billing plans offered in different countries made Rip and Replace impossible. And the different ways of operating made measurement, comparison, and sharing of improvement ideas difficult. The result, one telecom executive told us, was "like building a family by adopting teenagers."

The solution to this is to first understand how you do business – how you interact with customers, manage products, and work with your suppliers and other partners. Companies need exceptional process discipline to execute the Rip and Replace approach well. Then, identify the needed points of flexibility in your systems. In our experience, the Rip and Replace strategy only works when the acquisition is of a similar company with similar products and relationships with customers. And the Rip and Replace strategy doesn't only have to work in one direction. When Fleet Bank acquired BankBoston in 1999, it replaced its own systems with BankBoston's.

The Selectively Standardize Approach

With the Selectively Standardize approach, systems are merged through the connection of unique local systems with a standardized core. This approach is used when local differences in markets, products, or regulatory environments prevent a single standard way of doing business across the company, but the company still desires the cost reductions and productivity enhancements of standardized business practices.

ING DIRECT, the direct bank, uses a Selectively Standardize approach to expand its operations. At the core of the bank is an efficient and low-cost set of business processes and IT systems that it replicates in every country in which it does business. Yet it has built into this architecture the modularity it needs to handle the different customer needs and regulatory requirements of the different countries in which it does business. For example, the regulations between different countries (and even within some countries) for home loans vary a great deal. And treasury systems vary between North America and Europe. ING DIRECT's modular architecture allows it to swap out locally unique processes and IT systems, while leaving the bulk of its operations standardized across all countries. When ING DIRECT grows into a new country through organic expansion (such as its recent UK entry) or acquisition (such as in Germany) it can adapt the necessary parts of its architecture while keeping the core standard. This modular, standardized architecture is one of the major reasons that ING DIRECT has a cost structure one-sixth of that of a traditional branch bank.

The Selectively Standardize approach requires a high degree of technical sophistication. It requires the construction of a modular or service-oriented architecture – a building block structure of robust IT applications with standard interfaces that allow easy interconnection. Many IT vendors talk about this architecture, but few companies have it. Attempting selective standardization without the necessary modularity in your systems can lead to expensive failure. It's like building a toy house by gluing sticks together rather than stacking blocks – making changes to the stick house is more difficult and takes longer. Similarly, tailoring a standardized core is difficult if the core systems are hard-wired together.

The Connect and Coordinate Approach

In the Connect and Coordinate approach, IT focuses on enabling access to customer and product data and not on standardizing applications and business processes. This approach is best if the acquisition marries companies with complementary product lines and overlapping customers. When products and services are different in the two companies there is no need to standardize, but customers will expect the new company to provide a single point of contact.

MetLife, one of the U.S.'s largest insurance companies, has been addressing this challenge through a series of acquisitions over the last 20 years. MetLife realized that its customers wanted a single point of contact for the different types of insurance they offer – auto, home, and life insurance are different businesses but customers and insurance agents still expect a single person they can talk to that can answer their basic questions. So MetLife uses a Rip and Replace approach to its core technology, such as desktop, email, internet portal and related infrastructure services, but Connects and Coordinates its business operations.

The complexity of the company's operations, most of which were built by separate (pre-acquisition) companies around their insurance products, prevents standardization (and thus use of either of the two above approaches). But the company has identified the critical data needed to present a single face to customers. The IT unit has developed sophisticated software capabilities to access that data from the different systems of its acquired companies. These capabilities enabled MetLife to rapidly integrate its recent $11.5 Billion acquisition of The Travelers and generate record net income each of the last three years.

When Rip and Replace or Selectively Standardizing operations is not feasible, the Connect and Coordinate approach can still create value. Companies generate some economies of scale with a shared technology base and, perhaps more importantly, present an integrated face to their customers and other partners. Technically, however, the Connect and Coordinate approach is difficult and requires the acquiring company to develop a flexible and powerful portal that all parts of the new company can connect to.

The Operate Independently Approach

If the systems of both the acquired and acquiring companies are working well, it may be best to allow both companies to continue to operate their systems independently. UPS has created opportunities for growth by adding new businesses intended to feed its core package delivery business. New businesses like Supply Chain Solutions and the UPS Store have very different needs than the package delivery business, so they cannot benefit from UPS' economies of scale or standard IT-enabled business processes. Thus, UPS benefits most by allowing such subsidiaries to deploy independent business processes and IT systems. UPS will be able to share some of its systems expertise and data center capabilities, but the independence of its new businesses allows them to focus on what they do best.

For strategic expansions (whether through internal spinoff or acquisition) it may make sense to leave the systems in each company alone and operate the companies independently. There will be few operational improvements, but the transfer of expertise, people, and products may justify the acquisition. The danger of this post-merger integration strategy is that customers may not go along. Customers may demand that different parts of the same company act like one company, and may negotiate accordingly. And if your major customers know more about what they buy from you than you do, the true "cost" of unintegrated IT gets very large.

To succeed, first clean your own house

Due to the difficulty of integrating IT, some companies resign themselves to the Operate Independently approach regardless of the objectives of the acquisition. Others insist that IT deliver some synergies despite incompatibilities. The IT unit may then pick and choose the best systems of the acquiring and acquired companies and one-by-one hardwire them together, delaying the intended benefits of the merger and killing future flexibility. In

either case, companies don't receive the full value from the acquisition for years, if at all.

To position themselves for successful mergers and acquisitions, companies must first clean up their systems and processes. Most companies have excessive redundancy in their systems, processes, and data. Their IT units spend much of their time connecting isolated systems that must work effectively together, but weren't designed to do so. Combining these cumbersome technology environments with those of another company exacerbates the problem. Thus, attempting mergers prior to cleaning up internal systems is similar to sending an army into battle with half of each unit missing, and without any ammunition. The battle is lost before it's begun.

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For all but the Operate Independently approach, the challenge for the due diligence before your acquisition will be understanding how much standardization is possible, and to what extent your customers and partners will demand a single point of contact. The answers to these questions will determine the extent of the changes needed to your company's architecture. For Rip and Replace the focus is on the design of core business processes and scalability of IT systems. For Selective Standardization the focus is on which business processes have to be different in the different parts of the company, and to define the interfaces between these and the standardized core. For Connect and Coordinate, the focus should be on what critical data needs to be defined in a common way across the company. If you don't know the answers to these questions before the acquisition, the result will be a very expensive lesson.

About the authors

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1 We use the term “acquisition” throughout this article, but the ideas apply just as well to mergers of equals.

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