Opinion: Why IT Integration is Critical to Merger Success

(2006-04-28) - Written by CIOinsight

Post-merger IT integration can be a difficult, long-term, expensive proposition, but no merger can work without it, say two Booz Allen Hamilton consultants.

The colossal merger of Union Pacific and Southern Pacific in 1996 created the nation's biggest railroad, one that today covers more than 32,000 miles of track, with 8,000 locomotives and more than 100,000 freight cars. Yet integrating the two railroad companies was something of a train wreck.

Difficulty combining the two railroads' computer systems led to substantial service disruptions. The approach, according to Industry Week, was to gradually migrate Southern Pacific's aging systems to those of Union Pacific, but this resulted in unanticipated parallel processing for more than a year, hurting the railroads' ability to manage day-to-day operations. Railcars simply "disappeared," with customers unable to locate their shipments. When staff at one of the railroads received phone inquiries, they would refer the calls to the other railroad. Customers, the magazine quoted one source as saying, "felt like Ping-Pong balls." The resulting gridlock cost the nation's shippers an estimated $2 billion.

Read more about Union Pacific: Union Pacific Gets Back on Track

Ten years later, we find ourselves in the midst of another record-breaking merger wave – yet the lessons of the past have not been learned. Sadly, the mistakes these two railroads made in the mid-1990s are being repeated today.

From our vantage point, viewing numerous integrations across industries, it is clear that senior management still tends to approach IT integration in a perfunctory, arms-length manner. This both tempts fate and misses out on the very real benefits a well-planned and effectively executed IT integration can bring.

Next page: Reasons for IT Integration Failures

{mospagebreak title=' Reasons for IT Integration '}Failures">

There are two primary reasons for this. First, IT-enabled synergies tend to be fairly long-term benefits that require tremendous complexity to be achieved. For example, while many merger integration programs, such as sales-force integration and seamless order processing, are targeted to take place within the first six months of the close of the deal, a fair percentage of IT-enabled synergies require substantially longer, perhaps 18 months to 24 months past deal close.

These longer-term efforts include standardizing and converging enterprise data and application platforms, such as ERP and supply chain, as well as de-layering or eliminating organizational duplication and complexity. When faced with projects of such magnitude, senior management sometimes demurs, shifting its focus instead to synergies the company can achieve quickly.

The second reason management fails to fully embrace IT integration is that it usually requires significant investment – potentially hundreds of millions of dollars – in areas such as rationalizing applications portfolios, migrating customers and

products, and building new capabilities that combine the best of both companies. (Ironically, once explained, Wall Street will tend to accept these one-time costs.)

While we can sympathize with the pressure management feels to deliver savings, at its heart this approach is dangerous – putting the entire transaction at risk. We know this quantitatively as well as qualitatively. Our own Booz Allen analysis has found that about 15 percent of the synergy to be captured from a merger comes directly from savings on IT operations. With another 25 percent stemming from business operations where savings are dependent upon IT, the simple fact is this: $2 of every $5 in merger synergy comes in some way from IT.

A renewed focus on IT integration is clearly needed. Chief Information Officers and other senior IT executives need to make sure senior management is aware of those areas where IT integrations tend to stumble.

Next page: Common Integration Mistakes

{mospagebreak title=' Common Integration Mistakes '}

One of the common mistakes in the heat of merger integration is layering interim solutions one upon the other until IT effectiveness is hurt.

The problem, of course, is these shortcuts tend to outlive their "temporary" designations as the next top priority of the business quickly becomes the most important item on the IT agenda. The result is that redundant technologies and applications are allowed to survive in the merged company, creating a fragmentation of IT capabilities, technologies and architectures, and the attendant increase in costs.

For example, a merging entity may decide to maintain multiple enterprise applications and customer databases to avoid the initial cost and work of combining them, or simply to appease a business client in the short term. However, as new priorities emerge, these applications and databases tend to remain separate. This prevents fully integrated operations, limits the advantages of scale, introduces complexity, and limits flexibility over the longer term.

In those transactions where one partner is truly dominant, it's easy to fall into the trap of simply selecting the leading partner's systems to run across the combined company. It is the easy way, but often the wrong way.

For example, when one major banking company acquired a financial services firm a few years ago, the integration ran into precisely this difficulty. The bank decided to switch its newly acquired brokers over to its own technology platform. But according to Registered Rep, a magazine for the brokerage industry, one source complained the new platform was "about five generations behind" what the brokers had in the first place. This increased their workload, with one broker saying he had to start working on Saturdays again just to catch up.

While having a clear direction and moving quickly are important, the right way to approach this issue is to analyze the best of breed in each area of the two organizations. Then, management can pick and choose from the very best IT assets the combined entity has available.

When it's time to sit down and plan the IT merger integration, don't underestimate middle- and back-office integration

requirements. Doing so can cause IT synergy estimates to run 40%-50% too high.

The middle- and back-office tends to be where IT is at its most complex, rife with redundancy and fragmentation. Technology areas that get broader attention are improved over time, but challenges in the middle- and back-office are often swept under the rug. So, when it comes to combining these operations following a merger, the job ends up being much larger than anyone ever imagined.

We typically see back-office integration problems that include critical interdependencies, unexpected technology incompatibilities and requirements to support multiple systems well beyond their estimated timeframes. Go into this effort with eyes open, expecting to face unknown challenges.

Quite clearly, a successful post-merger integration must include a robust IT integration program. The best programs begin with rigorous IT integration planning and an effort to identify all major issues that may arise. They include detailed and objective assessments of IT capabilities, technologies and architectures, including the investment required for successful integration.

As critical, however, is the ability to define the integration so that it both implements quick wins and commits to the longer-term efforts needed to ensure a successful merger integration for IT itself and the business operations that are dependent upon it.

Tom Casey is a Vice President at the management consulting firm Booz Allen Hamilton focusing on Information Technology. Gerald Adolph is a Senior Vice President of the firm and head of its Restructuring & Integration group.