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MANAGEMENT CONSULTING

Post-Merger Integration

Business capability modelling and modular architecture design as value drivers for IT integrations

Authors: Markus Freimuth and Dr. Fabian Most

Introduction

Mergers & Acquisitions (M&A) are deeply strategic events which decidedly shape a company`s success for better or worse. Global transaction volume is constantly rising with respect to numbers of closings as well as complexity of transactions. In this regard, research has shown that post-merger integration (PMI) is the main driver of success or failure in M&A activities. About 50% of all deals fail partially or substantially with regards to an erosion of values during integration phases (see Ginkgo Whitepaper "Post-Merger integrations: In for a Penny - Out for a Pound").

Information Technology (IT) no longer simply supports but drives businesses and increasingly develops from a cost center into a revenue contributor and a strategic value creator. Consequently, IT becomes essential in most M&A (which are not purely a financial portfolio target) and often a critical success factor in PMI projects across workstreams. On the other hand, IT migrations and integrations are frequently among the most time-consuming and complex activities.

A major source of PMI failure in IT is that information and data about architectures are not fully available. Such an incomplete picture subsequently leads to faulty decisions. Consequences include surprises after Day 1 in terms of non-compatible platforms and technology stacks, misinterpreted functionalities, and criticalities of applications, as well as misaligned, missing or doubled capabilities. This leads to the principle questions of this whitepaper: What is the right approach to design a seamless IT PMI and how to master obstacles along the journey?

Ginkgo Management Consulting provides insights into its PMI methodology and guidance to companies on how to deal with those challenges. Using a capabilities-based post-merger integration approach can lead to better outcomes, but only if organizations have thoroughly planned for it. In the following, we introduce a capability-based PMI methodology, apply it to the IT integration and explain how key components of modern architectures, such as microservices, modularity, and a digital ecosystem, can be leveraged in PMI projects. Furthermore, we demonstrate how to use business capabilities in these post-merger scenarios and provide an analysis of the advantages and drawbacks of such an approach. The white paper closes by establishing how companies can identify their individual way forward.

1. PMI Approach and IT Integration

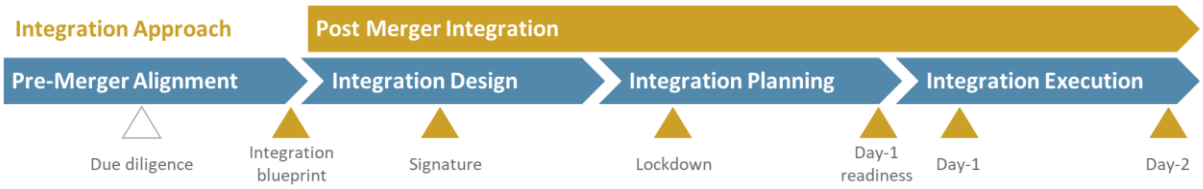
A structured approach entails all phases of the M&A lifecycle – from strategy formulation pre-deal to post-deal audits – as well as a distinct methodology to PMI which needs to be highly customizable for the largely varying requirements of different PMI projects (see graphic below).

In the following section, we will focus on this PMI methodology and provide a deep dive into typical challenges of merging IT Departments.

IT integration is a particularly crucial element as it is frequently the enabler of the overall integration and a bottleneck in many synergy-realization activities for the business. Also, IT project costs amount to 20% to 30% of the integration costs, compared to the small share of costs IT account for in the line organization (usually 1.8% to 3.5% of EBITDA).

The PMI approach ideally entails a four-step process (see graphic below):

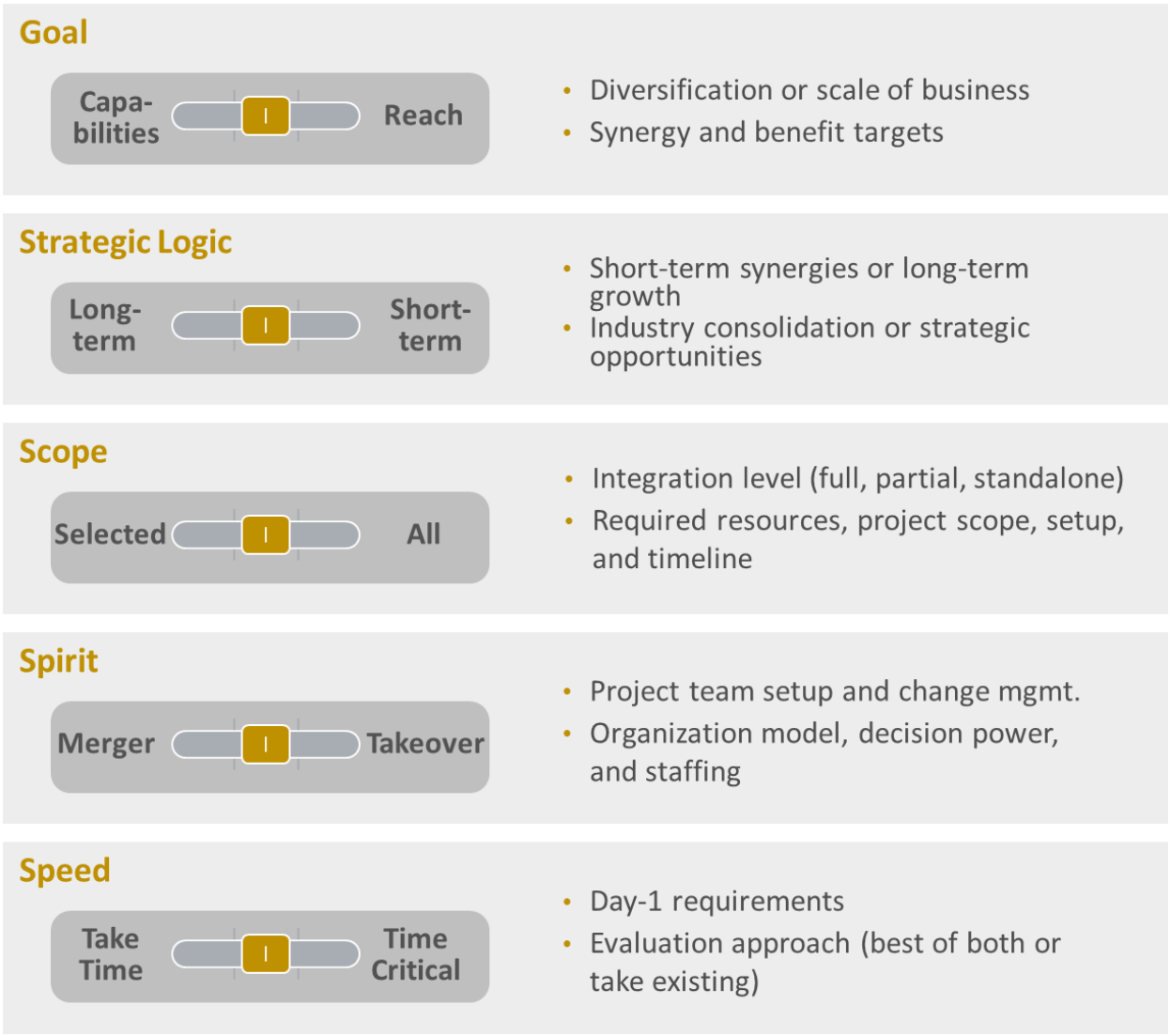
1. Pre-merger alignment: Despite the naming convention, we find that successful PMI project teams are involved pre-merger and ideally take part in the due diligence to guarantee full alignment on strategic direction, framework setting incl. KPI's, and analysis for integration design.
2. Integration design: During the Integration Design phase the framework and scope of the integration is defined, key stakeholders are identified and interviewed, synergy targets are refined and communication approach and plans are initiated as part of essential change management.
3. Integration planning: Based on the initial designs from the previous phase detailed blueprints of the future operating model and integration roadmaps including milestones for each workstream are developed in the planning phase to guarantee Day 1 readiness and coordinated execution.
4. The final integration phase is about execution of the PMI roadmap, local and functional rollout plans need to be coordinated and the PMI program needs to be actively managed with a high focus on dependencies. Furthermore, employee and customer programs are rolled out and synergy measures as well as continuous improvement efforts require tracking.



Even if no two integrations are the same, several key success factors have crystallized across varying integration projects:

A strong Integration Management Office (IMO) that provides advice and guidance to workstreams with a mix of a proven approach, IMO templates and smart problem solving to drive integration planning and execution has shown to be essential.
Change management with clearly set expectations and an integrated internal and external communications plan is another key success factor to favorable PMI outcomes.
Furthermore, for PMI project success, it is imperative to start with the end in mind, namely the business outcome the client is trying to achieve with the M&A activity. The overall business and integration strategy defines the "logic of the deal" and sets the direction and guidelines for the integration preparation and implementation. It provides curtail guidance for the program structure, operating model and key decisions on the target state of future functions. Therefore, executive sponsorship and commitment as well as a clear strategic overall concept are equally crucial for PMI success.

The purpose of the deal can be evaluated along five main dimensions: Goal, strategic logic, scope, spirit, and speed. (see graphic below).



Sharing this logic not only helps expedite change management and reducing uncertainty amongst employees, all these dimensions have a profound impact on the future operating model and functional integration roadmaps such as the IT integration. For instance, the integration goal (capability vs. reach) may determine the need to change and adapt systems and the integration scope possibly determines relevant business functions, regions and/or business units.
In this regard, alignment of overall strategy, deal logic and business outcomes with IT landscapes is imperative for integration success. Such alignment can be achieved through the usage of business capabilities. In the next chapter we introduce a capability-based approach whereas business capabilities should be in focus from the start of the integration process – commencing in the design phase at the latest. As a

strong vehicle that has increased in popularity over the past years, the following chapter will introduce the concept, how to apply it, as well as its advantages and disadvantages of implementing it throughout the integration process.

2. Achieving Business Outcomes Through A Capability-Based PMI Approach

Common approaches to achieve the alignment of business outcomes with functional requirements include the development of process landscapes or business capability maps. When comparing the two, business capabilities have some concise conceptual advantages over processes in the context of cross-company benchmarking and alignment:

Initially, the name and description of a generic business capability does not include technology, process, or company specific terms, so that the resulting business capability map becomes not only easier to understand, but also objectively comparable across organizations. On the contrary, processes can vary greatly between two different companies and even if their name is the same, the actual content can be very different from each other.

Secondly, business capabilities consist of three components: process, people, and technology. As a result, business capabilities change less frequently and are more stable over time than its components, for instance, a process.

Thirdly, business capabilities are ought to provide a holistic and mutually exclusive view of a company. Business capabilities should be designed as to minimize the interdependencies among them. This enables an independent analysis of single capabilities. In contrast, processes reflect the actual doing of a company and they are not optimized for independent analysis.

A typical use case for business capabilities is in IT. IT becomes increasingly embedded in companies' business models. Not only associated costs are on the rise, but IT also gets gradually more recognized for its value creation potential. In other words, many companies do not see IT as sole cost position anymore, but rather as a source of competitive advantage, potential new business models and revenue streams. Companies aware of this potential also naturally focus on a tight business-IT alignment. Business capabilities enable this alliance as they can be understood from both, business and IT. They provide a stable, easy to understand, and structured framework to analyse the technology component that is part of each business capability, usually in terms of applications and IT infrastructure. Adding all business capabilities of a company together leads to the business capability map of the company. This mapping exercise reveals a consistent view of the full IT landscape of an organization. Applying this view in the integration design allows IT to align and prioritize their activities according to the capabilities needed to achieve the defined business outcomes of a PMI.

Although these benefits sound promising, many companies start applying business capabilities without explicit consciousness and analysis of the requirements to apply them successfully. If business capabilities shall be able to create business value during a post-merger integration, a clear and transparent view on the underlying IT landscape per business capability and the possibility to look at them independently

is required (see example of a business capability map below).

Source: Ginkgo Management Consulting

A company's IT department is typically responsible for the IT business capability as well as an enabler of other business capabilities through their technology component. For instance, in such a scenario the IT Department would be responsible for running people, processes and technology of IT Governance while operating the ERP system, which is the technology backbone of the Finance business capability, at the same time. The challenge to combine functional and cross-functional IT requirements in the PMI setup is addressed through a dedicated IT workstream with the same responsibilities as the IT Department and close ties to the IMO for business alignment. By supporting the development of business capabilities that can be analyzed as independently as possible, by ensuring to focus on the right M&A activities, and by efficiently managing the adequate planning and execution according to defined timelines, a structured PMI approach with a strong IMO ensures focus on creating business value. In such an outcome- and capability-based approach, IT enables the realization of synergy targets and the creation of long-term value.

The better the business alignment and the maturity of the Enterprise Architecture, the better the outcome of the capabilities-based approach will be. Looking at the best practices approach to apply business capabilities, there are three steps worth mentioning:

1st Step: Transparency

As IT is becoming a value driver across business units and functions, it is crucial to get a holistic view on business capabilities and existing landscapes. Namely, the "inventories" of the two merging IT organizations on all Enterprise Architecture layers, which includes supported business capability maps, are the basis for all further strategic decisions. Hence, the first step is to identify whether both parties already

have comparable business capability maps. If they do not exist, it should be highest priority to establish them during the integration design phase since such maps are needed as early as possible in the PMI process. However, even if both companies already have existing capability maps, it is necessary to understand if they can be used for joint communication. This is only the case if they are not biased towards company-particularities, such as applications or technologies and if they provide the full picture of both companies, not only considering the "new world", but also the legacy systems.

Having established a capability map without having a transparency of one´s IT assets and having them mapped to the capability map is like using a language with great grammar rules, but without vocabulary. It is therefore just as important to assess and map value-adding processes, applications, technologies, and data that shall be considered in the PMI process. If something is not mapped at this point, it will not be considered in later steps of the process, which can also be reasonable with components that should not be part of the new joint company anymore. At this step it is advisable to investigate in which areas both companies have running microservices or other modular systems in place and in which domains they have highly integrated monolithic applications, covering large processes with too many established interdependencies that would potentially diminish the value coming from a business capabilities based approach.

2nd Step: Target Picture

Building on the overall business rationale for the merger, the Merger Type Analysis will enable the integration team to create the target picture, identify integration value levers as well as integration hypotheses. During the preparation phase the playbooks are developed that determine how we get to the desired target state and enable the different workstreams for a successful integration from Day 1. The two IT roadmaps and/or IT strategies should be individually assessed and compared. The target operating model will be able to build on these insights. The IT integration framework will be built in line with enterprise architecture principles and meta-frameworks in order to become a consistent part of the overall enterprise architecture. The initial mapping of relevant components from both companies is key to decide what to keep and what to discontinue based on capabilities and value streams, i.e. an evaluation of capabilities based on their underlying components in terms of business value and IT fitness.

An analysis model that evaluates business capabilities on these two dimensions based on their underlying components can help to achieve this objective. The business value dimension combines inputs such as the underlying benefits, potential synergies and costs, number of users, as well as risks. The IT fitness dimension includes inputs such as underlying technology maturity, lifecycles, and operational performance measures. One best practice is to stay flexible when it comes to choosing the input data that will then be binding across both companies. Experience has shown that applying the model with bad data quality can heavily bias the results. Moreover, there is usually not enough time for extensive data assessments. Experienced analytic experts can help with this issue by evaluating which data is really required, its quality, and which alternatives, such as correlated data sets, can be assessed with reasonable time and effort.

The result of this exercise is an indication of whether to take the underlying components of a particular business capability from one of the companies, from none, or to take a strategic decision that could also

include to keep both in parallel. It is important to understand that this evaluation provides a first view on how the target state should look like and should not be understood as a definite result. In contrast, the analysis should be iterated at least once and has the goal to highlight an optimal and objective IT architecture target state and to show the tangible implications that the business merger rationale would have on the current IT landscapes.

3rd Step: Transformation Plan

The last step is the development and execution of the transformation plan according to financial considerations, interdependencies, and business capability priorities. Equipped with the right level of information, an enterprise architecture guidance needs to be developed, results need to be consolidated into a joint roadmap, transformation plans need to be created and implemented and progress needs to be monitored for innovation potentials and continuous improvements. It is important to understand that the business-capabilities-based approach focuses on the target state i.e. Day 2, while for the Day 1 readiness, separate measures must be taken. For IT, the Day 1 measures focus on collaboration and workplace, applications, and organization (see exemplary list of measures below):

	Day-1 Readiness Measures	Description
Collaboration & Workplace	Standard communication setup (e.g. email addresses)	Users can receive emails and send emails from an email address of the acquirer
	Corporate directory / address book setup	Users can access a complete address book
	Joint collaboration platform setup (Teams, Skype etc.)	User have access to a joint collaboration platform
	User IDs setup	Users have an account (user and password) of the acquiring company
Applications	Internal appearance	Appearance at external agencies and service providers is adapted
	External appearance	Appearance of websites and applications is adapted
	Adjustment of forms	Forms and labels in applications are adjusted
	HR data	Basic HR data is available in HR system of acquiring company
	Finance data access and reporting	Financial data of both companies can be accessed, consolidated, and reported
	Intercompany business	Former business between both companies is now handled as internal business
	Master data	Master data management of both companies is compatible
	Application access	Users can access necessary applications on both sides
Organization	Security & compliance	Security and compliance is adequate for the new joint landscape
	Day-1 IT processes (incl. IT Service Management)	Adopted IT processes, including general IT Service Management processes
	Day-1 operating model	IT operating model is defined and ready at Day-1
	Vendor notifications	Vendors and external service providers acknowledge new company
	Country rollout	Country rollouts are planned as required
	User training	Ensure that required training is scheduled and executed e.g. for new applications
	User communication	Ensure that users receive regular updates about the integration and relevant actions

After Day 1, the defined roadmap is implemented. The IMO needs to ensure previously identified and unforeseen dependencies are moderated, estimated costs are tracked and synergies are fully utilized.

Moreover, the above-mentioned approach is increasingly facilitated through today´s technological advances. In the following paragraph, we provide a closer look into the most important technologies and how they add value in a capability-based integration. These apply to cloud readiness of applications, the ability of applications to run on different platforms, and the possibility to adapt to a fast-moving environment.

In addition, digital ecosystems in different contexts are relevant to that development. Gartner defined a digital ecosystem during the ITxpo Symposium 2017 as follows: “A digital ecosystem is an interdependent group of actors (enterprises, people, things) sharing standardized digital platforms to achieve a mutually beneficial purpose. Different ecosystems can coexist if separated by geography, market or category.” Thus, they require applications that are designed in a way that they can easily communicate and interact with other applications, also from different providers within the same ecosystem.

Such requirements led to the technological trend of designing applications as independent as possible therefore making them portable and reusable. While the aim to achieve this is already around for some decades, the underlying technologies are now capable to support such approaches, for instance:

- Microservices, which are small and independent pieces of modular software that work independent from their circumstances. Their goal is to provide a very particular functionality that can be reused in different contexts
- Container solutions, which are a way to make a piece of software work within different environments, such as different operating systems or cloud environments. This is achieved by including all required supporting services into the same container in order to eliminate interdependencies to anything outside the container

Such technologies do not only lead to huge opportunities for companies to increase the efficiency of their development efforts, to harmonize and streamline landscapes, and to drive down costs significantly. Applying them on a large scale throughout an IT landscape also allows to assess and analyze the landscape according to its business capabilities and the value that the business receives from every architectural increment. They act as an accelerator and value driver of the described pick-and-choose model of business capabilities during an (IT) integration.

3. Analysis – Advantages and Drawbacks

The outlined approach shows a potentially tremendous opportunity to apply business capabilities in the context of an IT PMI. Yet, it depends on the architecture's maturity of the companies: A less mature architecture has large systems, so called monoliths, that cannot be looked at individually and has not yet adapted to new technology trends and requirements. As such systems are often built along processes, a process-based analysis is often chosen. For example, a large ERP system impacts many different domains and has interfaces to many different applications. It would usually be analyzed along their major process flows, such as an Order-to-Pay process. More mature architectures have modular structures and have areas in which services and microservices have replaced big systems. Often, such architectures can be found in customer-facing areas, called System of Engagements. They provide greater flexibility and

enable higher transparency of both setups when merging two architectures. They provide the possibility to look at them in terms of business capabilities. An assessment of whether the architecture has a (micro)services-based or monolithic structure should be of high priority – not only in PMI projects.

Business capabilities provide the opportunity to benchmark, align, compare, and communicate in the same language between two companies with different skills, different cultural and architectural backgrounds. Compared to processes, they use the same language and they can be understood in the same way by different companies. Thus, they can lead to supreme results of an architectural integration project. However, key for successful usage of such business capabilities is that the prerequisites, such as the ability to divide the IT landscape into consumable modules that are mainly independent from each other, are in place and that the approach fits to the architectures at hand.

As this is never the case for legacy IT-environments and hardly ever fully available in born-in-the-cloud environments, thorough analysis is needed to which domains the approach can be applied. In addition, the concept of business capabilities is more abstract than the traditional process orientation, which leads to natural barriers in the realization of benefits from such an approach within the organization.

On the contrary, the proposed pick and choose approach – applied for a modular architecture with less assumptions and interdependencies – enables a company to easily interchange components of its planned target state without having an impact on the other parts. Overall, this will lead to a vastly increased transparency of the as-is landscape, as well as an improved evaluation of how the post-merger target state should look like. In addition, such a common framework facilitates the communication between the two companies, hence minimizing misunderstandings during communications especially in situations that require a clean room. A clean room is operated by a third party to control and note down everything that the two companies have interchanged. As such an institution can be very time consuming, it is strongly recommended to minimize the risk of misunderstandings between the organizations.

Taking the advantages and disadvantages into account, it becomes clear that an early involvement of IT in the merger process is inevitable. The benefits of a modern IT post-merger integration approach are obvious. However, the organization must first evaluate whether, in which domains and to which degree it is ready to undertake such an approach. Analyzing its digital readiness and modularity as well as sufficient time for preparation are first steps into that direction. IT should be closely aligned with the IMO throughout the entire integration process. Moreover, only if IT takes on a major role in the due diligence phase already and plays a strong part in evaluating the merger, it is possible to provide a suitable business capability map of both organizations on time. Without such a capability map, the integration is at major risk of failing to meet the set time and synergy goals due to unforeseen IT obstacles.

Summary of advantages and drawbacks of a pick-and-choose model of business capabilities during an IT PMI:

Advantages	Drawbacks
Increased landscape transparency and integration flexibility	Typically cannot be applied across the whole IT landscape
Optimized business-IT alignment of the integration	Requires a thorough analysis of whether the approach is applicable
Enhanced benchmarks, alignments, comparisons, and communication in the same language between two companies	Usage of a relatively new and abstract concept (business capabilities), which needs to be understood and embraced by the organization in order to work well
Enhanced analysis of both companies during integration design	Requires a business capability map in place that can be applied to both organizations
Increased value of a developed integration target state	
Facilitated communication between companies with different cultures or that cannot openly talk before Day-1	

4. Conclusion

Based on a multitude of project experiences of all sizes with the same patterns across industries, Ginkgo Management Consulting has developed a systematic PMI approach with a standardized analytical model. However, it is important to note that PMI projects vary widely with respect to different strategic logic, goals, and requirements. Therefore, an early involvement of the PMI team becomes beneficial to project success. This is particularly true for the functional area of IT in PMI due to vastly different IT-maturity levels of companies and the subsequent need to analyze the IT landscape of both companies early on.

A capability-based approach enables a structured PMI design as well as a successful IT integration at the same time. Initially, business capability maps provide a blueprint for the design of the PMI workstream structure to achieve the desired business outcomes. Additionally, through their technology component business capabilities provide the game plan for the alignment and prioritization of activities in the IT integration. While a full modularization of IT architecture into microservices will enable true plug-and-play integration of target companies, new ventures, platforms, or projects in the future, most companies are not ready for this. Thus, a pick-and-choose model of business capabilities enables PMI projects to reap the benefits from these technological advances today.

Mergers & Acquisitions offer unique opportunities to design new target operating models and implement (digital) transformation initiatives. Get in touch to learn how to embark on the integration journey towards a future ready IT and how Ginkgo can help you to get digital done!

About the Authors

Dr. Fabian Most
Manager

Fabian is a Manager at Ginkgo specializing in the areas of M&A, Post-Merger Integration, Service Management, Organizational and Digital Transformation. He wrote a PhD on Differences in Entrepreneurial Ecosystems in Munich, Singapore and the Silicon Valley, is team lead of the Competence Area on M&A and has 10+ years experience in Business & IT Consulting and Venture Building.

Markus Freimuth
Senior Consultant

Markus is a Senior Consultant at Ginkgo working in the areas of Enterprise Architecture Management, Post Merger Architecture Strategy, Digital Ecosystems, and Cloud Platforms. He is the team lead of the New Operating Model & Architecture competence area at Ginkgo Management Consulting.