People, Process, and Technology:

6 Considerations for Successful Private Equity Merger Integrations

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After several busy years of acquisitions, private equity (PE) firms are turning their focus to their portfolio companies.

BDO's 2023 Private Capital Survey found that as economic uncertainty persists, PE fund managers are focusing on value creation. With the reduction in new platform deals and exits, integrations and portfolio company optimization are at the forefront.

Proper integration can be challenging to get right, but when executed correctly, it is a powerful strategy for creating value.

A poorly managed integration can squander a deal's potential, delaying investor returns and turning once-promising acquisitions into slow-growing add-ons. Leading market practice is to focus on three core areas —people, process, and technology — which PE firms can use to help strengthen their integrations and capture the full value of their deals.

People

QUESTIONS TO ASK TO HELP AVOID PEOPLE PROBLEMS

How are the cultures of the two companies different?

How robust is the communications strategy used to support the merger?

How are you identifying and addressing potential leadership gaps?

OPPORTUNITY #1:

Ask the right questions about key roles at transition.

According to [BDO's 2023 Private Capital Survey](), talent management is the top value-creation lever fund managers and portfolio company CFOs plan to deploy in the next 12 months. Despite the importance of effectively managing talent during a merger, this is often where the most value is lost during a transaction.

Stepping back to evaluate the short- and long-term organizational structure and goals to plan accordingly will avoid maintaining redundant headcount in merged departments or hiring for positions that don't align with the newly formed company's combined goals.

A best practice is to talk to the leaders of the acquired organization about their people and conduct talent assessments to identify gaps and define areas of opportunity across the organization. Talent assessments can be a guidepost to make strategic decisions about the newly integrated workforce.

OPPORTUNITY #2:

Adopt a long-term cost optimization mindset.

Often PE firms delegate the decision-making around cost-cutting to a portfolio company's leadership team without providing them with the appropriate resources. Given leadership teams' many priorities and time constraints, talent topics can be delayed, resulting in lost value through unwanted turnover and decreased productivity. Rather than proactively designing the organization, we often see companies relying on natural attrition to reduce the overall headcount which can lead to short-staffed departments with inadequate skills. At times, PE firms cut headcount too deep and fast in the name of value creation without considering how those cuts will play out down the road.

Pivoting toward a long-term cost-optimization mentality versus a blunt cost-cutting approach can help reduce costs in the short term and unlock value later. Providing a leadership team with support and resources can pay dividends through accelerated value. In addition to looking at headcount, PE fund managers should identify areas where shifts in productivity can accelerate growth. Investing in employee reskilling or upskilling, for example, can help manage skills shortages and future-proof the business without adding extra hands. Also, seeking efficiencies by making changes to capital resources, like updating the technology infrastructure or shifting to new platforms, may help reduce costs and increase value.

Process

QUESTIONS TO ASK TO HELP AVOID PROCESS PITFALLS

Have you established clear transition goals?

Does your team have a full understanding of the newly acquired company's revenue cycle?

Is it clear which business processes are executed locally, centrally, regionally, or nationally?

OPPORTUNITY #3:

Immerse yourself in the business or industry's critical processes pre-merger.

By design, PE portfolio companies are often serial acquirers. It's not uncommon for these companies to acquire double-digit numbers of businesses, each with different processes. And it's also not uncommon for them to initiate merger integrations without detailed process mapping in place. Those who invest the time in understanding the business or industry's critical processes pre-merger will likely experience fewer surprises later on.

As PE continues to expand into healthcare, for example, some portfolio company management teams are struggling to integrate healthcare companies successfully as they may not fully understand the unique reimbursement cycle of the business. Coupled with poor cash flow integrations, portfolio companies end up borrowing money to fund operations and then need to hold on to the companies for longer than expected.

Understanding the cash flow process, defining the target operating model, and developing a strategic integration plan are critical starting points before a roll-up. Successful integration plans establish clear transition goals and build robust oversight structures to prepare every stakeholder for a smooth merger.

OPPORTUNITY #4:

Assess processes now so they don't become problems later.

Processes impact how seamless, accurate, and efficient the operational experience is for all stakeholders of an organization, including customers, employees, and vendors. Portfolio companies that fail to efficiently integrate processes from acquired companies can face several issues related to cost, operations, and more. However, those who attend to processes during integration can help avoid costly problems later.

When processes aren't well defined, process problems can quickly become people problems, so addressing them early is favorable. Your portfolio company may experience increased customer complaints, employee retention issues, and even challenges acquiring new customers. For example, when workforce processes are broken or poorly integrated, such as payroll, employees may become frustrated and dissatisfied, potentially leading to increased turnover. Or, if you have a poor customer process for billing in place, for example, problems can manifest as cash flow difficulties, customer relations issues, or even lost sales.

Technology

QUESTIONS TO ASK TO HELP AVOID TECHNOLOGY TROUBLES

Have you created a plan for consolidating enterprise resource planning systems?

Is the person or team enlisted to review the tech stack a daily user of the technology?

Have you identified the pain points users are experiencing with the existing technology?

OPPORTUNITY #5:

Closely review the company's tech stack from the shop floor through the back office.

Many PE fund managers are not doing enough due diligence or bringing in the right people to review the tech stacks of the companies they are merging, leading to misaligned technology and inefficiencies at integration. During the due diligence period, fund managers should review a full breakdown of existing technology partners and operating costs and evaluate redundancies and pain points users are experiencing with the existing technology.

The integration period is also an opportune time to implement new technology. Overhauling legacy platforms can be arduous and time-consuming. However, since the merging companies are already in the process of integrating systems, plugging in an outside technology partner during this time can allow for a more seamless integration experience now versus disrupting workflows later.

OPPORTUNITY #6:

Prioritize data integration.

The quality of your data determines the quality of your portfolio company's business. When the leadership team reviews their financials and key performance indicators, they may find unexpected people and process issues present if their data is poorly integrated. Issues may include frustrated customers, degraded customer experience, problems with suppliers, and even increased employee turnover. By integrating data correctly at the merger, you and your portfolio company's leadership team will be better able to understand the performance of the newly merged business and discover new opportunities to create value.

Enterprise resource planning (ERP) software integration is especially critical during a merger. An ERP provides visibility into operations, allowing you and your portfolio company to identify opportunities and unlock data to inform decision-making. Holding onto two ERPs after a merger may lead to a lack of visibility into operations, whereas consolidating into one ERP system can help a company understand the performance of the newly merged business and prevent expensive errors, operational inefficiencies, and more.

The Bottom Line

Taking a methodical approach to planning and executing portfolio company mergers and paying careful attention to integration, especially in the areas of people, processes, and technology, can help pave the way to realizing greater value in the future.

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