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M&A loves the cloud

Part of the *#Tech @the heart of M&A* series on M&A technology topics

While conventional M&A dogma has counseled to "transition, then transform," emerging cloud-based Enterprise Resource Planning (ERP) technology affords executives new options to have their cake and eat it too. Cloud technology now gives executives the opportunity to simultaneously transform not only their cost structure but also their capabilities by replacing aging, capital-intensive technology with a more flexible, subscription-based operating model that can ramp up or down as business needs dictate, as well as accessing advanced cloud-based capabilities based upon best practice.

Today's competitive business environment is driving companies to focus on core strengths and most profitable activities. Executives are increasingly looking to divestiture as a method to shed underperforming or non-core assets.

Amidst the focus on separation, it is often impractical to develop all of the required infrastructure to support the new organization, and it is common to include Transition Service Agreements (TSA) in which the seller provides post-deal, operational services or support to the buyer for an interim period of time after the transaction closes. As TSAs often include severe financial penalties for not exiting the agreement prior to the agreed upon date, there can be considerable pressure on both sides to exit quickly and with minimal impact to the business. This can be challenging, however, if the TSA includes support services for a traditional, on-premises or hosted ERP system, due to the complexity involved with ERP system configuration.

Moving to a cloud-based ERP system may help turn a potential M&A deal breaker into a deal maker. Opting for a cloud ERP solution can be a practical, less costly alternative to traditional on-premises or hosted solutions and should appeal to both seller and buyer. Requiring no hardware and nominal configuration, a medium-sized company can often be operational on a cloud-based ERP in four-to-seven months and a large international firm in approximately twice that time—both typically faster than traditional on-premises solutions—thereby facilitating a faster exit from the TSA. Considering that a cloud ERP typically provides regular upgrades, the ability to scale users, easy adjustments to system functionality, state-of-the-art security, and increased system capability, it may offer the ultimate in flexibility during a post-deal transition.

Selecting the right ERP platform

Choosing your cloud-based ERP platform should involve the same thorough due diligence as the rest of an M&A transaction. Each vendor has its own set of strengths and weaknesses and different approaches to managing and enhancing their product. There are pure-play vendors that solely focus on cloud and traditional on-premises vendors that have ventured into the cloud space. There are vendors that require you to stay current on all releases, and others that allow you to skip a release if you decide that you don't want to put your configuration through the system testing required to upgrade. Regardless of the vendor, there are a few keys areas that a buyer should consider when selecting a cloud ERP:

- **Buy for the present**—Prioritize the system capabilities you need to get off the TSA, and plan to add capabilities and functionality, as needed.
- **Use a two-tier strategy**—If you are acquiring a new subsidiary and have no plans to fully integrate it, then having this subsidiary run on a cloud ERP system can be a viable option. This option can provide the subsidiary a level of autonomy while minimizing impact on your current on-premises ERP solution.
- **Keep it simple**—To maximize the true value of a cloud solution and minimize implementation timelines, consider adopting the standard process workflows (e.g., Accounts Receivable, Accounts Payable) inherent to the system and limit customizations. The built-in functionality is typically based upon best-in-class processes, so there may be no need to change them.
- **Understand price drivers**—There are many drivers and strategies that vendors will use to price a cloud ERP. Expect to evaluate costs driven by:
  Users—Typically priced in tiers
  Transaction volumes—Data through the system
  Functionality—Core functionality is typically included (e.g., General Ledger, AR, AP) but additional functionality may cost more (e.g., multi-country, manufacturing)
  Revenue—Percentage of annual revenue
  Legal entities—Some vendors utilize this as a multiplier

- **Don’t forget third-party add-ons**—Even the most comprehensive cloud ERP solution may not have every piece of functionality you need to run your new business. In many cases, your needs can be addressed via an add-on or bolt-on application that is designed to work seamlessly with the cloud ERP solution. Typical bolt-on products include:

  Tax—handling of sales tax and use tax across multiple jurisdictions

  Reconciliation—bank, merchant, suspense, AR, AP, etc.

  Business Intelligence—advanced capabilities

  Integration Platform as a Service (iPaaS)—cloud-based applications that allow you to build connections between cloud-to-cloud and cloud-to-on-premises solutions

  Human Resources—full human capital management capability

  Payment gateway—Advances Automated Clearing House, electronic funds transfer, check printing capabilities

- **Decouple your ERP from your other infrastructure requirements**

  Minimal infrastructure required—That data center you need to build or migrate should not be a concern. There is minimal-to-no infrastructure investment (capital expenditure) required for a pure cloud solution, beyond an Internet connection and web browser.

  Evaluate data conversion and system integration transaction volumes—When large data volume transformation is required as part of the system integration or data conversion process, it is often more efficient to set up an on-premises-to-cloud iPaaS solution.

  Unmatched availability—Cloud-based ERPs are hosted in advanced data centers, often with guaranteed high availability. Locally hosted ERPs generally cannot match that level of availability without significant over-engineering (along with major cost implications). There are penalties in place if your cloud ERP instance is unavailable.

Cloud ERP isn’t for everyone

While it may appear as though a standard cloud-based ERP is a good fit for any M&A scenario, there are areas and inflection points where this approach may not meet an organization’s needs as well as an on-premises solution can.

High transaction volumes can exceed current cloud capabilities—While Cloud ERPs continue to improve their ability to handle increasingly larger annual transaction volumes, your specific volume needs may dictate either an on-premises solution or a cloud solution with multiple instances of cloud software. When developing your ERP solution architecture, you should consider working with your vendor to understand what counts as a transaction; determine your overall data and transaction volumes; identify the appropriate level of integrated financial reporting the organization requires; and decide if the organization needs a multiple-instance solution (anticipating that software and hardware advances will increase transaction volume capacity and capabilities over time).

Subscriptions can get costly—As mentioned earlier, a cloud subscription allows you to ramp up or ramp down costs based on your business needs but you pay for that flexibility. At a certain point your business may reach a size where a subscription to a cloud ERP may no longer be cost-effective. When developing your business case for cloud services, it is important to identify the inflection point where an on-premises solution becomes a more practical option.

Storage isn’t free—In a cloud environment, you pay for storage. This can get expensive with the inclusion of maintenance costs and storage device upgrades. If you expect to consume large amounts of storage (10 TB or more) or are required to store historical data for a significant amount of time (7+ years), you should develop an archiving strategy or be prepared to pay your ERP provider for high-availability storage.

Harnessing the power of cloud ERP

Cloud capabilities are enabling many organizations to fundamentally change the way they operate and to move from traditional, on-premises, large back-office infrastructure to an on-demand model.

Cloud-based ERPs have advanced in the past 15 years to a point that they now regularly compete head-on with traditional on-premises solutions. By selecting a cloud solution for a TSA, both the seller and buyer gain state-of-the-art technology, a subscription service with unmatched flexibility to grow with each business, and often zero-to-minimal infrastructure needs. Cloud ERP may truly be a cheaper, faster, and better solution for some post-M&A implementations.

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