THE FUTURE ERP: STRATEGIC M&A WITHIN PARTNER ECOSYSTEMS

GREENWICH CAPITAL GROUP

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INTRODUCTION

The world of Enterprise Resource Planning (ERP) systems is undergoing a significant transformation. ERP systems have long served as the backbone of businesses. Software vendors like SAP, Oracle, Infor, and Microsoft provide the backend software infrastructure that empowers the modern enterprise. ERP customers have extensively customized these systems and proceeded to maintain the original configuration for decades. However, legacy deployments are now struggling to meet modern business requirements and standards. Consequently, customers are compelled by necessity to migrate to modern platforms on an accelerated timeline.

This industry phenomenon presents a tremendous opportunity for qualified partners capable of delivering on the implementation, development, and support of cloud-based ERP platforms such as S4 HANA, Oracle Fusion Cloud, or Dynamics 365. However, capitalizing on this opportunity is proving to be exceptionally challenging. ERP providers have built modern platforms on dramatically different codebases and platforms than previous versions, making migrations a complex process with high business risk for their customers. Guiding customers through this transformation demands specialized expertise. Resources to meet this demand are limited.

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Owners and investors of ecosystem partners have limited options to build out these migration capabilities in-house. In a high-interest rate environment there is scarce availability of capital to fund growth initiatives. Even in the event of wide capital availability, the talent pool with a track record of providing these services is limited and highly sought after by major players in the ecosystem.

Leaders of these organizations are facing growing pressure to accelerate their operations, both from external and internal sources. Externally, this pressure is coming from their existing customers who are grappling with a growing array of complex business challenges, supply chain disruptions, and competition from innovative business models introduced by competitors. Internally, private equity investors, who have a significant presence in this sector, are also exerting pressure. These investors are seeking robust growth while insisting on maintaining a disciplined approach to subsequent investments.

The most efficient use of time and capital under this shifting set of industry dynamics is strategic M&A focused on either buying modern platform capabilities to meet the industry demand or selling a highly valuable set of customer relationships and support services. This customer base will demand the advanced capabilities of the strategic acquirer and provide a sustainable pipeline. A mutually beneficial path forward for both buyers and sellers will continue to accelerate consolidation in this space. In this article, we break down the contributing factors.

THE LONG TAIL OF LEGACY ERP PLATFORMS

The entire ERP ecosystem is in a state of disruption or, in some cases, reinvention. The risk of business disruption has traditionally created an aversion amongst enterprise customers to migrate to modern platforms. In turn, this has created a large backlog of supported versions for the ERP software vendors. In the capital environment of the last decade, large enterprises were incentivized to pursue growth above all else, and the efficiency of their internal systems was de-prioritized, provided it was sufficient to support further growth. With the rising cost of capital, businesses are forced to do more with less. Growth initiatives that were once the norm are now scrutinized by investors evaluating the financial return. This is where modern ERP platforms and the proliferation of AI throughout IT systems can change the equation and transform the efficiency of the organization.

Not only are customers compelled to modernize their systems by market forces, but the long tail of supported versions is crushing the software vendors themselves. SAP, Microsoft, Oracle, and Infor are accelerating the time horizon for customers to move off previous versions. SAP has been holding onto ECC for well over a decade. They continued support for another four years but recognized there was a significant revenue event in moving customers into the modern standards. This trend will accelerate as ecosystem partners and ISVs abandon services and support practices for versions they know will be shortly out of service.

Migration from legacy ERP systems to modern solutions has no easy path. There is a tremendous shortage of professionals with the necessary skills in this complex field.

CAPITAL AND TALENT SECURITY

Building out a modern ERP migration practice is a capital-intensive initiative, and many partners may find themselves limited in financial resources to explore the opportunity fully. Prior to the 2nd half of 2022, capital was readily available to fund growth with plenty of private equity money flowing into the space. Higher interest rates have changed that environment,investors are demanding a different risk-return profile in their growth equity investments. This limits options to address these problems. Even if businesses raise capital, it doesn’t guarantee the success of the strategy.

ERP providers have built their modern platforms on a dramatically different base of code than previous versions. This has created an industry dynamic where migration from legacy ERP systems to modern solutions has no easy migration path. There is a tremendous shortage of professionals with the necessary skills in this complex field. Talent in the partner ecosystem is notoriously hard to find. Partners are fiercely competitive in attracting and retaining people. ERP groups are continuously pulling talent out of the ecosystem into their own organizations for pre/post-sales support and of platform development. Both factors make talent scarce and expensive to attract and retain. This problem is coming to a head as huge demand meets an even narrower supply of talent.

M&A RATIONALE AND STRATEGY

The ERP industry is evolving rapidly, and integration partner ecosystems are at the center of this transformation. Depending on your firm's positioning, either buyside or sellside M&A activity is a strategy which must be considered.

For a partner of significant scale that has proven capability in modernization initiatives, relevant targets will have a robust install base and legacy support or managed service contracts that can fuel your pipeline for the years ahead. Switching ERP support providers has high switching costs. The software vendors historically have put-up barriers for partners to compete for each other's business through their compliance requirements in the partner program. Historically, this has reduced churn and maintained stability in the ecosystem. If your business development initiatives are hamstrung by these industry forces, acquiring pipeline and securing market share through M&A is the most effective alternative. With so much change pushing the industry forward, there will only be a few big winners and many firms missing out.

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Partners throughout the ecosystem are securing a consistent flow of migrations, but frequently are not able to capitalize on their customer's demand for services. The partner ecosystem faces systemic challenges in developing modernization practices. The window of opportunity for exiting at a premium is closing, consolidation will be a leading indicator of the modern ERP implementation industry gaining momentum. M&A will slow as the heavy waves of customers begin to modernize. The business you have built has the potential to be even more valuable within the right strategic partner.

An M&A advisor with the right set of experience and relevant activity in the market can help you engage with the right counterparty at the right time. This can make all the difference toward achieving a premium outcome. Greenwich Capital Group has the industry knowledge to understand the trends in the space, and the network of industry participants to advise you on the best path forward. We would love to discuss our perspectives further. For inquiries please reach out to Greenwich Capital Group's Managing Director, **Jeff Goodman**.

Jeff Goodman
Managing Director

3 Maryland Farms, Suite 180
Brentwood, TN 37027
Mobile: (404) 217-1004
jgoodman@greenwichgp.com

ABOUT US

GREENWICH CAPITAL GROUP

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