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How Coty Tackled Post-Merger Supply Chain Integration

– Ben Worthen, CIO

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On Dec. 14 and 15, 2005, Coty, one of the world's largest cosmetic and fragrance makers, held an all-hands-on-deck executive meeting at the company's headquarters in New York City. Five months earlier, Coty had acquired Unilever Cosmetics International (UCI), a subsidiary of the eponymous conglomerate, and Coty's IT team was just finishing moving UCI employees off Unilever's infrastructure and onto Coty's. This was tedious work, such as switching people from Outlook to Lotus Notes, the sort of project Coty CIO David Berry calls "brainless." Now, Coty's IT department was itching for a challenge.

But not the one Berry was handed at the meeting.

UCI's order entry, processing, financial, warehouse and shipping systems were still different from Coty's. The newly merged entity was like a corporate Noah's Ark, carrying two sales forces, two marketing departments, two financial teams and so on, preventing Coty from gaining the efficiencies it had counted on when it laid out $800 million for UCI. At the New York meeting, Coty CFO Michael Fishoff told Berry that he had to have the companies integrated by the end of Coty's fiscal year, June 30, 2006.

In other words, he was giving Berry six months.

"Integration means the supply chain," says Berry, an American based in Haarlem, the Netherlands. And the supply chain was a mess; it spanned 10 countries, employed four ERP systems that fed three warehouse systems running five major distribution facilities on two continents. And now Berry had to figure out a way to get all those systems to communicate with one another. And do it in 180 days.

On his flight home, Berry had a couple of drinks and thought, "How are we going to pull this off?" By the time he got off the plane, he was, in his words, "a nervous wreck."

A Mania for Mergers

Mergers and acquisitions follow the stock market. M&As peaked in 2000, with $3.4 trillion spent on almost 39,000 deals, and dropped considerably when the market crashed. But over the past few years, as the market has rebounded, the number and value of M&As have crept back up. In 2004 companies spent $1.9 trillion on M&As; a year later, it was $2.7 trillion. Through November 2006, companies spent $3.3 trillion on almost 33,000 M&As, a rate that puts 2006 on pace to be the largest year ever for M&As.

Dan Dalton, a professor at Indiana University's Kelley School of Business, says that companies have gone on an acquisition binge because record profits and soaring stock prices have left them more liquid than at any time in the recent past, and there are only three things they can do with the cash: save it (an option that executives favor but investors frown on); pay it out to shareholders in the form of dividends (which investors like but executives don't); or use it to grow the business by acquiring another company (which, if it works, makes both executives and investors happy).

Unfortunately, M&As usually don't work.

Anywhere from 65 percent to 80 percent of M&As never deliver a real return on investment, according to Stephen Kaufman, a senior lecturer at Harvard Business School. "They end up destroying shareholder value rather than enhancing it," he says.

There are two principal reasons why M&As fail. First, to acquire a company, one has to pay more than it's worth—"10 to 15 percent above market value," says Dalton, who says the extra cost covers the premium necessary to convince a company to sell as well as the debt the buyer assumes to fund the acquisition. The result is that acquirers invariably start off in the hole.

The second problem is that while acquisitions are almost always made with a clear goal in mind—for instance, expanding one's presence in a market or entering a new one—integrating the two companies can take so long that it throws off the calculations that were used to determine whether the deal was a good idea in the first place. "Indecision is the worst and most corrosive chemical in a merger," says Kaufman. Each minute spent trying to decide the best way to integrate is a minute spent paying for things that are not generating value. That's why, Kaufman says, "It's better to be 100 percent fast and 70 percent right, than 70 percent fast and 100 percent right."

What Coty Bought and Why

Coty was growing rapidly—its revenue jumped from $1.9 billion in 2004 to $2.1 billion in 2005—thanks in large part to a strategy that emphasized celebrity-branded perfumes. Coty's roster is headed by big names like Jennifer Lopez and Celine Dion, soccer star David Beckham, country singer Shania Twain and tween icons Mary-Kate and Ashley Olsen. UCI, meanwhile, owned one of the fashion industry's biggest names, Calvin Klein, as well as other top brands. But cosmetics is a noncore business for Unilever. And so, in July 2005, Coty finalized the deal, paying Unilever $800 million for the $600 million subsidiary, and agreeing to future payments (contingent on profit goals) that could be worth an additional $100 million.

For Coty, the deal represented an opportunity to become a larger player in the prestige fragrance market of high-end perfumes like Calvin Klein and other top UCI brands Vera Wang and Chloe. Coty also believed it could reap economies of scale from having just one sales force, marketing group and so forth selling and managing two sets of products. And it hoped to retain the best people from both organizations. But if the integration wasn't done quickly enough, not only would Coty not gain those economies of scale, it could scare away its best people.

"People like to have a clear vision of the future," says Michele Scannavini, president of Coty Prestige, who works out of Coty's Paris office. "When [a merger] takes too long, anxiety grows and you risk losing the key talent in the organization."

Coty faced the same risk with its customers too. "The retail trade wants to know how you're going to go to market," says Coty CFO Fishoff. "Now, all of a sudden, we're one big company. But we're not doing business as one company. We still have two salespeople, and you have to get two different shipments." Until it consolidated its two lines, Coty risked losing the raison d'¿e for the acquisition and risked alienating its customer base.

And that's not what it shelled out almost a billion dollars for.

"Good Enough" Integration

Upon returning to Haarlem, Berry and his team began developing their strategy for making sure Coty didn't fritter away the advantages it sought in the UCI acquisition. The June 30 deadline made speed paramount. Berry would focus on the processes that had to be completed to merge the two workforces. Everything else, from daily sales tracking to real-time order monitoring, could wait.

Traditional systems integration is an all-or-nothing proposition: You teach one system to speak another's language. If it can't learn, it flunks. That's why these projects can drag on for years. But Berry needed a different philosophy and a new methodology. And he knew what it would be. In September 2005, Coty had signed a deal with iWay, a middleware vendor, to facilitate developing a service-oriented architecture (SOA). The SOA was intended to help Coty manage a $500 million procurement outsourcing deal it had just signed with IBM. But in November Berry had gone to a Gartner conference in Cannes, France, that focused on using SOA to integrate disparate systems faster than traditional integration projects were able to do.

Rather than teaching each system all the other systems' languages, the SOA could act as a universal translator. (An order in SAP would be rendered as a service, which could be recognized by, say, J.D. Edwards, without having to reconcile the two languages.) The only thing the Coty team would have to teach the software would be the business processes. For example, what that order looked like and where it should be routed and under what circumstances. If they could do that right, Berry and his team might make the June 30 deadline.

"You don't want to be one of those guys whose merger didn't work because it took too long," says Berry. "So I bet the farm that this was going to get the job done."

What's Critical, What's Not

The flip pad on the easel in the corner of Berry's Haarlem office is down to its last sheet of paper. On that sheet is a diagram explaining how SOA works—red ink for the systems, green for the data flows, black for the names of the systems. And since explaining how SOA works and getting his staff to understand this new way of thinking (services, not applications) is one of Berry's hardest jobs, he hasn't let anyone touch the pad in more than a year.

Berry didn't realize what he was getting himself into until a two-day meeting that took place Jan. 11–12, 2006, in a conference room at the Zoete Inval Hotel directly across the street from Coty's Haarlem office. Twenty-five key process owners, from functions including finance, customer service, distribution and IT, were going to create the integration plan. It was the first time that many of them had ever met.

"We are not a technology company," Berry told the audience. "We can't be writing code."

The point of an SOA, he continued, is to map the tasks that applications perform to the processes that a company follows in the course of doing business. At the technology level, these tasks—for instance, shipping an order—are translated from the proprietary language of the system that performs them into services written with XML-based standards. At the business process level, these services can be moved around and used over and over again to build new applications without ever having to write new code.

Berry told his audience that the purpose of the first day was to understand the processes that everyone used. Each of the representatives took turns talking about how they did their jobs and how they used their systems. What emerged was a picture of how the company worked.

The new company had five distribution centers. The two inherited from UCI—in Lille, France, and Mount Olive, N.J.—ran on the J.D. Edwards platform. One Coty center in Germany ran LM6, the other, Ratioplan. The North Carolina center ran Oracle/COPs. They were all, says Berry, "old and tired." Furthermore, each country had unique processes (and in some cases, technologies) that had to be accounted for.

Italy, for instance, is already using the SAP system on which Coty will eventually standardize. The largest customers there usually place orders at the individual store level and expect products to be delivered directly to those stores. But England uses a legacy ERP system from JBA, and Coty's largest customer there, the Boots pharmacy chain, places orders by EDI and has them delivered to central warehouses.

There were smaller differences that the integration project would have to accommodate as well, such as label reformatting. The SOA project would have to identify all of these and turn them into universally readable services.

The day ended with a formal dinner and resumed on the morrow, focusing on how Coty was going to make all this happen. "We didn't have to build the Taj Mahal; we just needed a roof," says Gary Gallant, Coty's vice president of information management for the Americas, who came along in the UCI acquisition. "For example, we could have said anytime someone creates an SKU we need to replicate that in every system, but then we never would have made our go-live date." Instead, Coty limited its focus to anything that touched the customer: sending an order to the warehouse, ship notification, billing and so forth—what Gallant calls "the bare necessities of order management."

This focus on customer-facing processes came at the expense of internal ones. For instance, Coty's business leaders were used to receiving a daily report tracking sales and inventory levels. But Berry decided that integrating that report with the new UCI products would have to wait until after June 30. This was not a popular decision with the business leaders, but the daily reports, as nice as they were, did not directly affect customers.

In order to minimize the confusion, Berry decided to create small SOA project teams: one project manager, four IT directors and an iWay consultant in Europe, and an even smaller team in the United States. The countries that already had the SAP system in place would be integrated by Accenture, Coty's partner on the SAP project. Berry says that creating small teams was one of the best decisions he made.

"Too many brains can work against you," he says. "We didn't have the time to listen to every alternative." Smaller teams didn't require costly overhead like dedicated office space, and, most important, eliminated chains of command that might have prevented Berry from getting timely and candid feedback on whether "we were on the right or the wrong track."

Integration Ho!

The next five months were intense for the project teams and Coty's IT executives. Phone calls to the United States at 3:00 a.m. became routine, according to Gallant.

The Coty team spent the first few weeks mapping processes and determining what in fact touched the customer and therefore needed to be included in the integration. Actually integrating the processes was the easy part; one of the team members would take a process—for example, an order notification from a salesperson—and describe what each field should be, if the date needed to be flipped from European to American formatting, which distribution center an order needed to be routed to and so on. Because the applications were being converted into services, the Coty team could set these up with a drag-and-drop tool and didn't have to do any coding.

Accordingly, the team spent most of its time testing. In many cases testing was done the Friday, Saturday and Sunday preceding a Monday go-live date.

One particular test stands out in Berry's memory. It was the end of March and Coty was planning to go live with the SOA in Spain, France and Italy on April 1. Berry watched as the system processed several hundred orders. At the end of the day, he called a distribution center in Germany to see how things had gone, and the manager there basically said, "What orders?"

It turned out that the system could not figure out what to do with the orders so it parked them rather than releasing them or kicking them back. The project team created a new process rule: Orders that can't be delivered should be bounced back to the sender.

The Coty team found other problems, both large and small, and fixed them as it went along. The company went live with its U.S. distribution facilities in April, the United Kingdom and Ireland in May, and Germany, Austria and Switzerland in July, just after the fiscal year–end deadline.

The Sweet Smell of Success

Thanks in large part to the added revenue from the former UCI products, Coty recorded a record $3 billion in earnings in 2006. Meanwhile, the IT department's work allowed Coty to combine sales and marketing forces as planned at the beginning of the 2007 fiscal year in July.

But while the speed work was finished for the IT group, its job was far from over. It now had to go back and work out all the details it had neglected during the integration, such as those daily reports the business leaders wanted (they now have a Web-based tool that can give them any data they want) and real-time monitoring of transactions (Coty now knows the moment there's a problem with its systems).

There was also time to reflect on the project. If there's one thing Berry could do over, he says, it would be to take the design of the end-state architecture more seriously. Given the manic pace of the project, he didn't think that he had time to stop and come up with one; instead he figured the end state would evolve naturally over the course of the project. Finally, in May 2006, he gave in to pressure from the iWay consultants to articulate an overall systems architecture. It turned out to be a relatively easy process, taking only a couple of days to produce a working blueprint. This allowed him to get a pretty good idea of what pieces of technology he would need to replace and when. "Get it nailed down early," he recommends.

Coty is still working on its global SAP system. Over the next couple of years, it will deploy financial, business planning and some manufacturing modules in Europe and the United States. And wherever it needs to touch another system, the integration will be done with SOA.

As for the SOA itself, using it as an integration tool is only the beginning. Ultimately, Coty intends to use it for business intelligence and to facilitate its move to being a real-time company.

But first things first. "[The integration of the two companies] may not be the most perfect or efficient, but orders are coming in and going out," Berry says.

Now, he says, "We're doing a lot of fine-tuning."

Buying Spree

Eight of the 10 largest acquisitions* ever were made in 2006

Acquisition	Value	Purchased by
HCA	$21.2 billion	Bain Capital, Kohlberg Kravis Roberts and Merrill Lynch Global Private Equity
Clear Channel Communications	$18.7 billion	Thomas H. Lee Partners and Bain Capital Partners
Equity Office Properties Trust	$17.9 billion	The Blackstone Group
Freescale Semiconductor	$17.7 billion	Firestone Holdings
Harrah’s Entertainment	$17.2 billion	Apollo Management and Texas Pacific Group
Kinder Morgan	$14.6 billion	Goldman Sachs and AIG and other partners
Univision Communications	$12.1 billion	Saban Capital Group, Madison Dearborn Partners, Providence Equity Partners, Texas Pacific Group and Thomas H. Lee Partners
Albertsons	$10.9 billion	Supervalu and CVS

Source: Thompson Financial
*The largest acquisition ever was Kohlberg Kravis Roberts & Co.’s 1998 $25.1 billion purchase of RJR Nabisco. Filling out the top 10 is Chevron’s 1984 $13.4 billion purchase of Gulf Oil.