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Editors:
Huang, Wayne Ohio University, USA
Teo, Hock Hai National University of Singapore, Singapore

Host University:

Department of Information Systems
City University of Hong Kong
83 Tat Chee Avenue
Kowloon Tong
Hong Kong

Co-organizers:

University of Science and Technology of China  Fudan University

Association for Information Systems
41. INTEGRATION OF DIFFERENT ERP SYSTEMS – THE CASE OF MERGERS AND ACQUISITIONS

Andreas Von Vangerow, University of Auckland
Michael David Myers, University of Auckland

Abstract

Mergers and Acquisitions (M&A) are very important for the external growth of companies and tend to have a very high profile in the media. The recent proposed acquisition of Yahoo by Microsoft is a case in point. However, research in finance has shown that many M&A initiatives fail in terms of the expected financial outcome. The reasons for failure include cultural problems and a lack of operative integration, which can be at least partially related to problems with Enterprise Resource Planning (ERP) systems integration.

Despite the high importance and profile of M&A in the finance literature, surprisingly little IS research has looked at how different ERP systems might be integrated in the case of M&A. Therefore this paper suggests a preliminary model for ERP systems integration in M&A. The model is based on the research literature related to M&A, ERP systems, and interviews with M&A professionals.

Keywords: ERP, enterprise resource planning, mergers, acquisitions, integration, Business Process Reengineering.
INTRODUCTION

Mergers and Acquisitions (M&A) are booming again, with the proposed acquisition of Yahoo by Microsoft being one of the most recent examples. However, the research literature in finance reveals that two thirds of all M&A initiatives fail in terms of the expected financial outcomes (Henry, 2002). The reasons for failure include cultural problems and a lack of operative integration (Haspeslagh & Jemison, 1991), which can be at least partially related to problems with Enterprise Resource Planning (ERP) systems integration. ERP systems are company-wide information systems that integrate all major business activities such as finance, operations and distribution (Al-Mashari & Al-Mudimigh, 2003). Unfortunately the IT department is usually not perceived as a strategic partner in M&A and therefore is often not involved during the planning process (McKiernan & Merali, 1995).

Despite the high importance and profile of M&A in the finance literature, surprisingly little IS research has looked at how different ERP systems might be integrated in the case of M&A. The current literature in this field can be categorised into three areas: Some authors have identified relationships between strategic objectives and IT integration (Mehta & Hirschheim, 2004; Wijnhoven, Spil, Stegwee, & Fa, 2006), some focus more on organisational implementation success factors (Brown, Clancy, & Scholer, 2003; Robbins & Stylianou, 1999a, 1999b; Stylianou, Jeffries, & Robbins, 1996), and two approaches cover more technical aspects (Henningsson, 2007; Sumi & Tsuruoka, 2002).

The purpose of this paper, therefore, is provide a review of the literature in the area of IS integration in M&A, and to suggest a preliminary model for ERP systems integration in M&A. The model tries to integrate strategic, organisational, and technical aspects and is based on the research literature related to M&A and ERP systems. The model was developed further based on interviews with IS integration professionals who work in the field of M&A. We hope that our model along with some proposed guidelines might help companies to improve their ERP Systems integration efforts in future.

This paper is organised as follows. Section 2 provides a literature review related to M&A and ERP systems. Section 3 describes the research method. Section 4 discusses our proposed model for the integration of different ERP systems in the case of M&A. Section 5 is the discussion section, while the last section is the Conclusion.

LITERATURE REVIEW

Mergers and acquisitions

In an acquisition, a target company is acquired and absorbed by the bidding company and after the deal only the bidding company survives, while the target company goes out of existence (Hunt, 2003). A merger, sometimes also denoted as a consolidation, differs from an acquisition in that two companies join to form an entirely new organisation (Gaughan, 2007, p. 12; Giacomazzi, Panella, Pernici, & Sansoni, 1997, p. 290). This involves crossing the stocks and integrating all of the components of the two companies to form a new company (Giacomazzi et al., 1997, p. 290). In practice and in academia, the terms mergers, acquisition, and consolidation are often used interchangeably, because they differ only in terms of legal aspects (Gaughan, 2007, p. 12; Giacomazzi et al., 1997, p. 290).

The whole merger and acquisition process consists of several different stages, but in general three broad phases can be identified: Pre-Merger, merger, and post-merger (Haspeslagh & Jemison, 1991, pp. 12-14; Jemison & Sitkin, 1986; Mehta & Hirschheim, 2004, p. 2). The pre-merger phases encompasses: Setting of strategic objectives and planning, search and screening for a partner, due diligence, negotiation, approval by officials, and the announcement of the deal (Haspeslagh &
Jemison, 1991, pp. 12-14; Mehta & Hirschheim, 2004, p. 2). The merger phase (typically quite short) begins after the agreement of the shareholders of both parties and ends on the first day after the new legal entity is formed (Haseslagh & Jemison, 1991, pp. 12-14; Mehta & Hirschheim, 2004, p. 2). The post-merger phase involves the integration of the two entities and usually ends after the major part of the organisational changes have occurred and the new company has settled down (Haseslagh & Jemison, 1991, pp. 12-14; Mehta & Hirschheim, 2004, p. 2).


2.2 ERP systems

Enterprise Resource Planning (ERP) systems are commercial software systems that integrate and at least partially automate a large proportion of business processes within all functions in a firm such as finance, operations, human resource etc. (Al-Mashari & Al-Mudimigh, 2003, p. 22; Gattiker & Goodhue, 2005, p. 560). Most of the Fortune 1000 firms have adopted ERP systems today (Ranganathan & Brown, 2006, p. 146).

ERP systems enable companies to restructure their whole business and to implement best-practice processes that are embedded in the software (Davenport, 1998). There is empirical evidence that the implementation of an ERP system is a worthwhile undertaking which leads to higher profit and market values of the firm (Hitt, Wu, & Xioage, 2002; Ranganathan & Brown, 2006). However, such success should not be taken for granted as success may vary depending upon the phases of an ERP implementation project (Larsen & Myers, 1999; Markus & Tanis, 2000).

2.3 Integration of information systems in the case of mergers and acquisitions

The integration of different Information Systems (IS) is one of the most critical challenges that companies face during the whole post-merger integration process (Harrell & Higgins, 2002, p. 23). The existing literature mainly covers three different aspects of IS integration in M&A: Strategic aspects, organisational aspects, and technical aspects.

2.3.1 Strategic aspects

Giacomazzi et al (1997) suggest a model to relate different strategic objective of mergers and acquisitions to different software and hardware configurations. First of all, the company has to define their strategy and the relating growth objectives. Second, the company has to evaluate whether the business of the acquired company is equal, similar or different. The locations might be the same, or in a different country. After assessing the rest of the situation a company should carefully evaluate the IS requirements such as economies of scale due to centralisation of computer systems and business process and information management standardisation. The final step is the selection of the IS integration strategy with the choices of total-, partial- or no integration (Giacomazzi et al., 1997).

Wijnhoven et al. (2006) see the IT integration problem as an IT alignment problem and their main research question is to find out which IT integration strategy is the best for which merger situation. Their starting point is the four perspectives of the IT alignment model: Business strategy, IT strategy, organisational infrastructure and processes, and IT infrastructure and processes (Henderson & Venkatraman, 1993). They propose four alternatives for IT integration in the case of M&A: Renewal as an IT integration mode means that the IS and the business process of both the acquiring and the acquired firms are going to be renewed (Wijnhoven et al., 2006, p. 10); Takeover means that the IT system of one company replaces the IT system of another company; Standardisation refers to
software and hardware standardisation for similar business processes often according to a so-called “best-of-breed” approach, while **Synchronisation** means the creation of interfaces between the IS of the companies for communication and data exchange (Wijnhoven et al., 2006).

Perhaps the most sophisticated model in the area of integration of IS in M&A is the model developed by Mehta and Hirschheim (2004), which consists out of three different lenses: **Symbolism**, **power**, and **strategic alignment**.

The authors define **symbolism** as the so-called Wall Street Effect or the Efficiency-as-Ends Mantra (Mehta & Hirschheim, 2004, p. 2). The pressure of the Wall Street community heavily influences the pre-merger and merger phases and the decisions made in those two phases have a huge impact on the post-merger phase. The Wall-Street Effect focuses on short-term goals which requires excessive cost-cutting and does not give the acquiring firm the necessary time to assess the acquired firm properly and to follow a best-of-breed approach in the case of IS integration (Mehta & Hirschheim, 2004, pp. 2-5).

The **power** lens pays attention to the differences in power between the acquiring and the acquired firm. The authors show that the acquiring firm uses an internal and external system of influence to dominate the acquired firm in order to enforce its goals, which are often dominated by the Wall Street Mantra (Mehta & Hirschheim, 2004, pp. 5-7).

The **business-IT-strategic alignment** lens depends on the overall external growth strategy. An **efficient** IT role is achieved by process-level improvements and realised by a centralised IT structure. An **opportunistic** IT role aims for market flexibility and therefore requires quick decision making for exploiting new opportunities. It is realised by a decentralised IT structure. A **comprehensive** IT role aims at careful decisions and quick responses and can be realised with a hybrid or shared IT structure (Mehta & Hirschheim, 2004).

Another approach which solely covers strategic aspects of IT integration in M&A is the work of Henningsson (2007), whereas Alaranta and Henningsson (2007) focus more on planning aspects and on the process of IT integration in M&A. Johnston and Yetton (1996) build up a matrix with two dimensions: IT merger strategy and IT configuration.

**2.3.2 Organisational aspects**

The approach of McKiernan and Merali (1995) is one of the founding articles of IS integration in M&A. They suggest an acquisition life cycle consisting of six steps. The first two steps are undertaken before the merger, steps three and four during the actual merging phase, and steps five and six after the merger. It is only during the last step that the IS strategy for the now unified company is aligned with the overall business strategy of the merged entity.

Stylianou, Jeffries, and Robbins (1996) and Robbins and Stylianou (1999b) propose a framework to explain the impact of post-merger systems integration on IS capabilities. Organisational factors, such as the size of the company or decision making processes, and IS factors, such as degree of fit between the systems of the merging companies or personnel skill levels, influence IT integration success. Part of the model shows how IT integration success can be measured (Stylianou et al., 1996). They suggest that improved IS capabilities should support the overall M&A objectives and IS resource utilisation is categorised into efficiency and effectiveness (Robbins & Stylianou, 1999b, p. 207).

Alaranta (2005) tries to build a framework for the integration of Enterprise Systems in M&A by simply using a framework for ERP implementation. However, none of the factors in the model are specific to the M&A environment. User resistance, a lack of IS expertise in top management, and insufficient usage of formal project management methods are not specific to the M&A environment, but will occur in all ERP implementation projects.
2.3.3 Technical aspects

In the current literature on IS integration in M&A there are two approaches which cover more technical aspects (Henningsson, 2007; Sumi & Tsuruoka, 2002). The first approach makes suggestions for successful IS integration based on the companies’ general policy of IS utilisation (Sumi & Tsuruoka, 2002). The second approach looks at how Service Orientated Architectures (SOA) can be deployed for integrating IS in M&A (Henningsson, 2007).

3 RESEARCH METHOD

Although the main purpose of this paper, as mentioned earlier, is to provide a literature review and suggest a preliminary model for ERP systems integration in M&A, we decided to conduct some preliminary qualitative research to add some depth and “face validity” to our findings.

One of the authors conducted interviews following the dramaturgical approach suggested by Myers and Newman (2007). A semi-structured interview approach was used because it leaves enough room for improvisation and thus, the researcher was able to explore different aspects of the field under study and to capture much of the knowledge of the participants (Myers & Newman, 2007).

Interviews were conducted with three IS integration professionals who work in the field of M&A. One works as a manager for a large company in the agricultural sector situated in Asia/Pacific, and two work as consultants for one of the major international consulting firms. Although the number of interviews is relatively small, all three professionals have already experienced several mergers in different companies and are considered to be experts in their field. Thus they have an excellent understanding of the issues.

Thematic analysis was used for data analysis. The audio tapes of the interviews were analysed for sentences and structures which matched key areas from the literature review (Miles & Huberman, 1994). These parts of data were then used to illustrate or to challenge the findings of the literature review.

4 A PROPOSED MODEL

Based on our review of the research literature and our interviews, we propose a model regarding how to integrate different ERP systems after an M&A initiative. This model is shown in Figure 1.

The ERP Integration strategy is mainly influenced by four macro dimensions: M&A Objectives and Business Strategy, Power and Politics, Organisational Infrastructure and Processes, and IT Infrastructure and Processes. All of these dimensions also influence each other.

The first dimension of M&A Objectives and Business Strategy shows that the IT Integration strategy needs to be aligned with the overall business strategy of the newly formed company. Companies have to consider what types of strategic capabilities are going to be transferred. The expected synergies are expected to results in cost savings, often economies of scale, revenue enhancements or access to technology.

The manager we interviewed commented that one goal in the merger of a large agricultural company was the elimination of inefficiency in the supply chain. They used the ERP system as an enabler of this change.

The second dimension of Power and Politics is particularly important in M&A. The power distribution between the companies has a large influence and usually the managers of the acquiring firm use several methods to ensure that their IT systems are used in the newly acquired firm (Mehta & Hirschheim, 2004). This will influence the selection of an ERP integration strategy as well.

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Another of the consultants we interviewed recommends a draconian approach when it comes to systems standardisation for low value-add functions. He says that the managers of the acquired firm have to make clear that they are the winning party and that they acquired the other firm because they are better and more successful. The standardisation of the systems should therefore be made very fast (within six months) and the managers of the acquiring firm must ensure that there is no turning back.

The support of the top management is a key ingredient for the success of the ERP integration project, while the role of consultants and the ERP vendor is also critical.

The third dimension of Organisational Infrastructure and Processes stems from the classic approaches of strategic alignment of IT (Henderson & Venkatraman, 1993). Organisational structure and organisational culture are certainly key issues for the consideration of an appropriate ERP/IT integration strategy (Main & Short, 1989). The greater the difference between the cultures and the structures between the firms the harder it will be to actually integrate the two companies.

During integration, well prepared and extensive change management is needed to bring the two different cultures together, and transfer process knowledge and skills. The way a company does business is embedded in their ERP system and in their business processes. If the two systems of a company are going to be combined together, the way of doing business and the culture of the companies needs to be combined to a certain extent. The key success factor for this change is proper business process reengineering and change management.
The fourth dimension is **IT Infrastructure and Processes**. The research literature states that a certain amount of standardisation and prior merger integration experience make the whole integration project much easier (Giacomazzi et al., 1997; McKiernan & Merali, 1995; Robbins & Stylianou, 1999a, 1999b; Stylianou et al., 1996; Sumi & Tsuruoka, 2002). This shows that an assessment of the entire system landscape before the merger is probably the best way to guarantee a successful project. But managers should be careful not to make false assumptions.

One of the consultants we interviewed said that it is very hard to integrate different releases of one SAP ERP system, for example, and even for the same release there are still many obstacles due to the software modifications and interfaces to other systems which companies usually have in place. This consultant therefore recommends the standardisation of modules for low-value-added processes and the use of Service Oriented Architecture for creating a middle layer for connecting the different systems that still remain afterwards. But he also adds that SOA is expensive and makes the connected systems inflexible.

The benefits from the ERP integration project can be categorised into operational, managerial, strategic, IT infrastructure and organisational benefits (Al-Mashaari, Al-Mudimigh, & Zairi, 2003; Shang & Seddon, 2000). The exact definition of the **Benefits** of the ERP system integration project and the alignment with the expected benefits of the whole merger and the business strategy for the newly formed company in the future is the key part, which should determine the ERP integration strategy. The companies also have to distinguish between short-term cost cutting goals (e.g. reducing headcount by combining two IT departments) and long-term business goals like process improvement and revenue enhancement. They furthermore need to know that a trade-off between those two goals exists, and that heavy cost cutting in the beginning may destroy the base for future growth because the company loses too much knowledge and skills.

The manager of the agricultural company stressed that they reached both goals, cost-cutting (because of increased supply-chain efficiency) and revenue enhancement (as a result of the increased agility of their business especially in foreign markets). One of the consultants pointed out that in his opinion the key synergy is the reduction of the total cost of ownership, especially for low-value-added functions.

The definition of the functional and physical **Scope** of the project and the allocation of the resources (time and budget) can then be derived from the ERP integration strategy and the expected benefits from the merger. If the managers consider all of the aspects mentioned earlier, this should ensure that the project scope is defined appropriately and the resources in terms of time and budget are sufficient for realising the project.

One of the consultants said that an appropriate scope is of key importance for a project. He further commented that heavy scope-cutting if a project runs out of budget is the biggest problem for consultants, because the company usually still insists on the delivery of the expected business benefits.

### 5 DISCUSSION

The integration of two ERP systems is a complex and challenging project, which involves several trade-offs. The two main trade-offs are the degree of standardisation and independence between the two former independent systems and the speed of integration of the companies and systems.

The first trade-off is the decision regarding to what extent the systems of the acquired company should be integrated into the existing systems of the acquiring company or vice versa, or whether both systems should be replaced by a new system altogether. The existing approaches relate this question either mainly to the external growth strategy (Giacomazzi et al., 1997; Mehta & Hirschheim, 2004) or to the integration approach (Hwang, 2004; Wijnhoven et al., 2006). We believe that both aspects need to be considered and thus the existing approaches might be misleading.

The literature which examines the effects of large ERP implementation projects suggests that projects with a larger scope in terms of included business functions, and not just project size, create higher
excess shareholder returns (Hitt et al., 2002; Ranganathan & Brown, 2006). In the light of these studies, we suggest that a higher degree of standardisation between the systems of the two companies seems to be appropriate in order to capture most of the long term benefits. On the other hand, there is research which shows that integration is not a goal in itself and that divisions of a company which operate in different business areas might be better off to have independent ERP systems (Lee & Myers, 2004).

For integrating different ERP systems in the case of M&A, the contradictory results from the literature can be interpreted in the following way. A high degree of integration of the different systems can provide large benefits, if the kind of business of the companies is similar, but the success of the integration project should not be taken for granted. In general, the higher the integration of the systems, the more time and money should be spent for BPR and change management. This is also in line with one of the consultants we interviewed who reported that it is much easier to integrate systems than to integrate processes. If the processes are reengineered properly, the integration especially of low-value added processes can result in cost-savings and performance improvements.

For high value-added processes, the situation is even more complex. In this case, the efforts for BPR and change management need to be higher because the competitive advantage is embedded in those processes. But even in such cases we believe that at least some integration will return benefits if the integration project is managed properly taking account of the categories stated in our proposed model.

The real core capability of ERP systems integration is the ability to draw a flexible line between standardisation and independence of the systems with regard to the particularities of the merger and the systems and tools in use. Thus the real competitive advantage in information technology is the knowledge of IT on two layers: First of all, it is the technical knowledge about how to integrate the systems and how to set up flexible but still manageable interfaces relying on Service Orientated Architecture; secondly, it is the ability to manage the whole integration project and to integrate the two organisations with their distinct processes, culture, and employees. Therefore, IS managers should build up capabilities for ERP change management to come up with an evolving IT strategy in the long run. Such a strategy should also enable the company to complete a learning cycle after each acquisition.

The second trade-off in an ERP integration project in M&A is the speed of the entire integration project. Managers can choose a fast and tough integration or a slower and more careful integration. Both approaches have advantages and disadvantages.

The advantages of a fast and tough integration are that the companies are able to realise short-term cost-saving benefits very fast, in order to fulfil the expectation of the stock market. Such cost-savings typically result from a fast reduction of the head-count of the IT and other departments of the companies and a fast close-down of now dispensable ERP/IT systems and other facilities.

Another advantage is that most employees expect that a lot of their colleagues will lose their job after a merger. Often the whole company is put on hold while the employees do not know the particularities of the integration project (Ashkenas, DeMonaco, & Francis, 1998). Thus, a fast and thorough integration will bring the companies back to normal business faster. Also, employees like to have clarity about their personal situation for the next few years. This opinion is also in line with the opinion of one of the consultants we interviewed, who recommended a fast and draconian approach especially for low value-add functions such as HR, Finance, or Purchasing.

The disadvantages of a too rapid integration project are that the companies do not have the time to assess the ERP systems and the related business functions carefully and therefore are not able to follow a sufficient best-of-breed approach. Thus, they do not actually know whether they have implemented the best parts of each company. This can lead to a loss of knowledge and skills because the specific knowledge and skills were embedded in the organisational culture of the companies, which no longer exists (Haspeslagh & Jemison, 1991). Specific knowledge regarding how to manage the processes of a company is closely related to the ERP system and hence, only transferring the data from one system to
the other and closing down one system can lead to a loss of competitive advantage. As described by Mehta and Hirschheim (2004), the heavy focus on short-term cost-cutting goals is heavily influenced by Wall-Street analysts. Although this practice is very common, it may be responsible for the reduction of shareholder value in the long run (Henry, 2002).

Slower and more careful integrations therefore have the advantage that the companies have more time to assess the different ERP systems, the embedded knowledge, and the culture of the two companies. Thus, they are able to capture more of the knowledge and this should result in increased synergies in process improvement and revenue enhancement over time.

Disadvantages of slow and careful integrations are that the companies realise cost savings synergies later and that both companies are usually put on hold during the whole period of the integration project. Another disadvantage is that companies might lose a lot of knowledge and skills in the form of employees. The reason for that is that most employees will anticipate that many of them will lose their job and thus they start searching for a new job and leave the company as soon as possible. The situation often becomes worse because professional head-hunters try to get the best people from an acquired company just a few days after the first announcement of the deal in the media (Brown et al., 2003).

As the consideration of the advantages and disadvantages of the two strategies has shown, both of them are loaded with risks. We believe that the best advice for a manager would be to consider integration aspects already in the pre-merger planning phase and communicate the plan to the employees as soon as possible. The model introduced in this essay should be able to give some assistance for the planning process, especially if the managers relate the expected short-term and long-term benefits to the project.

Hence, a careful approach, combined with an excellent communication and change management strategy plus generous retention packages for employees with key knowledge, is most likely to be the best approach. The project at the agricultural company, for example, took three to four years until it was completed but was regarded as a long-term success because the company was able to improve its market position significantly.

In conclusion, the integration of ERP system in M&A is a difficult undertaking, which needs to be planned carefully. It would seem that a higher degree of integration, combined with excellent BPR and change management, will most likely provide more long-term benefits when the business of the acquired company has at least some similarities.

6 CONCLUSION

Mergers and Acquisitions (M&A) are a fact of business life, yet few IS researchers have turned their attention to how different ERP systems can be integrated when two companies join together. We have suggested that this is a potentially important new area for IS researchers. It is important because, according to the research literature in finance, two thirds of all M&A initiatives fail (Henry, 2002). The reasons for failure include cultural problems and a lack of operative integration (Haspeslagh & Jemison, 1991), which can be at least partially related to problems with Enterprise Resource Planning (ERP) systems integration.

Based our review of the literature, and interviews with three experienced IT integration professionals working in the area of M&A, we have proposed a tentative model of ERP systems integration after an M&A initiative. This model (Figure 1) shows those dimensions which influence the selection of an ERP integration strategy and how the ERP system integration strategy is related to the business benefits. Dimensions that influence the ERP systems integration strategy are M&A objectives and the overall business strategy, power and politics, and organisational and IT infrastructure and processes.

The selection of the appropriate ERP systems integration strategy also involves two main trade-off decisions. First of all, the level of standardisation and independence between the two former
independent systems has to be defined and the time for the whole post-merger integration project has to be allocated. With regard to the first trade-off, the outcome of our research is that a higher degree of standardisation combined with excellent BPR and change management is recommended, when the business of both companies has at least some similarities.

With regard to the second trade-off, we recommend a more careful and slower integration process in combination with a comprehensive planning process, an excellent communications strategy, and generous retention packages for employees with important knowledge. This should enable companies to retain the knowledge that is embedded in the processes and culture, which are supported by the ERP systems, and to retain the knowledge that is in the heads of the employees.

Our research has implications for both IS researchers and practitioners. For IS practitioners, our proposed model should help them to evaluate what factors influence their ERP integration strategy, what benefits they can expect, how the project scope of the actual project should be defined, and how to allocate the resources. This should support their planning process and the implementation project. As a result, practitioners who take all of the dimensions of the model into account and who carefully define their ERP integration strategy should be able to create more shareholder value out of their M&A initiative in the long run. Of course, competitive advantage does not come from the technology itself, but from the ability to create a unique solution out of the systems of both of the companies, which cannot be easily imitated by competitors (Ciborra, 1994, p. 4, 2002).

For IS researchers, our proposed model is a useful starting point for further empirical research. As the purpose of this paper was to provide a review of the literature in the area of IS integration in M&A, and to suggest a preliminary model for ERP systems integration in M&A, we acknowledge that our findings are relatively limited. We interviewed only three IS practitioners (although all three are experts in ERP integration and have been involved in multiple projects). Hence, we call for more empirical research to validate and/or modify our proposed model.

Future research could also look at how it might be possible for companies to develop an evolving ERP systems integration strategy, one that is able to adapt more rapidly to changes in the business environment.

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