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Perils of
Financial Sector
M&A
*Seven Steps to
Successful Integration*



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EXECUTIVE SUMMARY

Capital market upheaval is producing the most significant structural changes in decades and creating historic opportunities for financial services institutions—to launch mergers with and acquisitions of competitors, and to acquire the portfolio of assets held by individual divisions of their rivals. Governments around the world are encouraging this restructuring as they intervene in the troubled financial sector. The U.S. Treasury, for instance, is buying assets of ailing banks, which will eventually be placed back on the market; it is infusing hundreds of billions of dollars into the system, some of which can be used for mergers and acquisitions; and it is even offering to cover some of the risk taken on by stronger financial services firms that are acquiring their weaker cousins. European central banks are also stepping up their intervention by providing liquidity and lending guarantees. Regulatory changes to enhance government oversight of all these institutions seem certain.

Financial sector executives may have many years of experience in M&As, but they need new discipline and processes in this environment of unprecedented market volatility, consolidation, and capital flow. In particular, they must guard against surprises on the balance sheets of the firms being acquired, and they must take new steps to assure clients and employees that stability and reliability will be maintained. Most of all, they must have a step-by-step plan to make sure that the early stages of integration are so carefully plotted and closely watched that the odds of the acquisition being a sustainable success increase significantly.

A NEW BURST OF M&A ACTIVITY

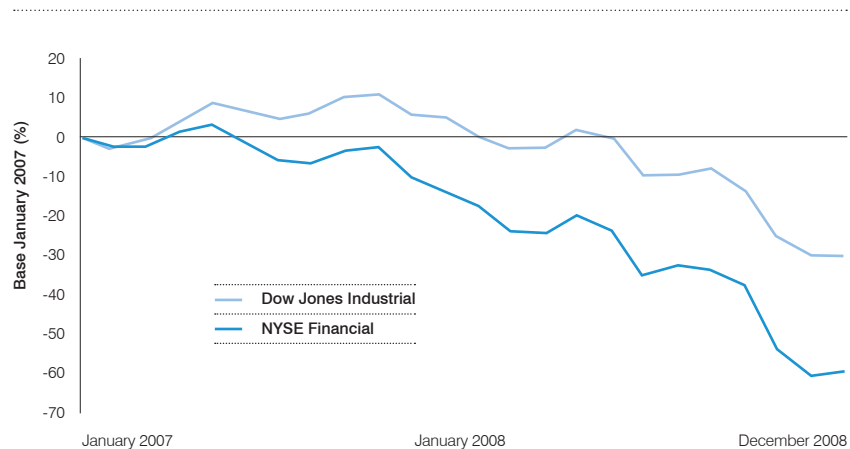
Recent months have exposed the most widespread credit crisis seen in decades. Banks and other financial services firms around the world have suffered significant write-downs, and securitization markets have tightened, exacerbating the turmoil. Consequently, stock prices of financial services firms have fallen significantly, making more and more companies desirable takeover candidates (*see Exhibit 1*).

Some institutions are seizing the opportunity to acquire competitors, increasing their scale and seeking to benefit from the market discontinuity. For instance, Barclays acquired assets from Lehman Brothers, Bank of America bought Merrill Lynch, and JPMorgan Chase & Co. acquired

Bear Stearns and Washington Mutual. Some of these acquiring institutions are actively seeking to become so large that they achieve “too big to fail” status. Other institutions are going in the opposite direction: divesting underperforming businesses and implementing cost efficiency initiatives, hoping to improve their resilience. This activity is occurring in the retail banking, mortgage, investment banking, and other sectors.

To a much greater extent than ever before, governments and regulators are allowing and even encouraging this burst of mergers and acquisitions to ensure the stability of financial markets. This is a stunning new development—governments are offering attractive financing alternatives to

Exhibit 1
Stock Prices for Financial Services Firms Have Fallen Further Than Other Sectors



Source: Wall Street Journal, Booz & Company Analysis

those willing to take over ailing institutions, create stronger balance sheets, and participate in market restructuring.

But just as in the past, when M&As often failed to meet the lofty value generation expectations of those who initiated them, too many institutions are not prepared for this burst of integration activity. In the first place, they may lack the tools and processes to properly understand the inherent worth of firms they are contemplating acquiring. And once they have acquired either an entire firm or a portion of it, it often becomes clear that they have not sufficiently thought out their integration game plans.

Acquirers have generally fallen back on familiar approaches to complete the new round of M&As in financial services. Top management has sought to retain key clients of both institutions even if the brand name of one or both firms is changing. Although the very

operating model of the financial institution may be changing and branches or offices may be eliminated, the business has had to keep an eye squarely focused on customer segments and deliver uninterrupted services to them. Part of this delicate balancing act is learning how to capture the benefits of cross-selling services from one institution to the customers of the other.

In addition, companies have understood the need to retain and motivate talented professionals by addressing their cultural differences, devising large-scale internal communication programs, and implementing large training programs. Executives have also learned how to integrate operational and technological platforms, as complex as that always is. And, of course, leaders of acquiring firms have become quite adept at eliminating overlaps and redundancies in sales teams, branch networks, and general overhead costs.

Too many institutions are not prepared for this burst of integration activity.

THREE NEW SUCCESS FACTORS

All of those sets of competencies remain important. But in these troubled times, the M&A process must also be viewed in a different light, in which three integration success factors gain additional importance.

First and foremost, executives of acquiring institutions need to quickly assess, control, and manage the risks of the enterprise. Integration teams must quickly determine the status of the book of business, looking for fragilities associated with the current environment (for example, derivatives and mortgage-backed securities). This is all the more relevant today because due diligence teams have very limited time to conduct an in-depth appraisal of a target's financial statements. At the same time, those statements have become significantly more complex because of the use of new leveraged instruments. Management should also resist the temptation to immediately lay off staff involved with poor credit decisions, because they possess impor-

tant knowledge of relevant transactions and internal procedures.

Second, in a market fraught with fear, management needs to recognize that even minor operational mishaps affecting customers could cause them to take their business elsewhere. This is not a time to place operational efficiency above customer loyalty. So acquirers need to pay special attention to reliability during the transition period, even at the expense of running platforms in parallel for some period of time.

And third, remember that the staff of the institutions being acquired may have been traumatized. This makes it even more important to boost the morale of the integrated staff and to win the loyalty of new employees. That requires a transparently fair appraisal process, which will encourage competent staff to remain in the merged organization.

SEVEN-STEP PLAN FOR INTEGRATION

To address both the traditional and new challenges, we recommend a seven-step process that allows top management to run integration programs with a clear sense of purpose and direction, from the early stages of the due diligence process to the final throes of the integration. Integration teams must resist the temptation to develop processes on the fly, which typically confuses collaborators, derailing the integration effort. The seven steps involve different sub-teams, all within the planning and integration team, that take on various aspects of the work separately or together (see Exhibit 2):

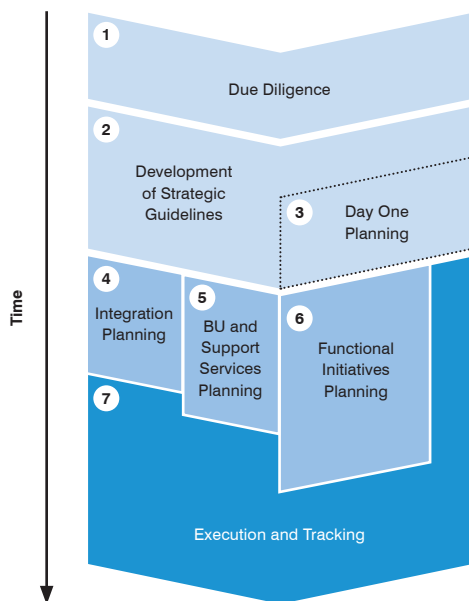
1. *Due Diligence.* As transactions become more complex, due diligence teams must go beyond the traditional basic financial and actuarial analyses. They must understand new market segments, growth trends, the skills

and capabilities of the target company, and the fabric of the competitive landscape. Such mapping allows management to make informed decisions about the target's strategic fit, the most important integration challenges, and how to integrate the acquisition target. The due diligence teams must achieve this more comprehensive view over a very limited period of time.

2. *Development of Strategic Guidelines.* This stage should be characterized by an intense dialogue at the senior management level that establishes key integration objectives and high-level financial targets. Integration leaders must set up the governance structures, allowing integration team members to quickly focus on their specific initiatives. At the end of this stage, the organization should be able to articulate the vision for the combined business, how the new organization will create value, and the key plans to implement the strategic intent. As the social and political outcry for a stronger banking system escalates, leadership teams must make it clear that they will ensure the security of depositors, continue prudent lending policies, and adopt responsible remuneration policies for senior staff.

3. *Day One Planning.* As the deal is being struck, executives must maintain a strict focus on the few key activities that are required for deal announcement and business continuity. Those include internal and external communication initiatives, business decisions aimed at quick wins, adjustments in the focus of commercial teams, revised limits for credit lines, pricing structures for similar services, and adjustments of specific human resources issues. Potential information technol-

Exhibit 2
The Booz & Company Bank Merger Integration Approach



Source: Booz & Company

ogy and operational roadblocks need to be clearly understood.

4. Integration Planning. Integration teams should be created by this point. These teams should be multifunctional, meaning that members have a variety of expertise and are not just, for example, analysts. These teams must have top performers on them, rather than being seeded with marginally effective managers. And these teams must be empowered with clear decision-making rights. Once established, these teams must develop high-level plans that provide a broad view of key milestones and interdependencies. These interdependencies have become more critical recently as progress in risk management, IT, and physical infrastructure has a deeper impact on the ability of business units to function. Finally, team members must define short- and long-term brand strategies and the rationalization of product offerings. This plan provides senior management with visibility into how the integration will be achieved.

5. Business Unit and Support Services Planning. During this stage, members of the business units and support services detail their individual plans. This increases the overall accountability level. As part of the business unit planning, these teams need to provide a comprehensive list of activities and responsible parties, a detailed work plan, an assessment of resource needs, risk mitigation plans, and key performance indicators for subsequent progress tracking.

6. Functional Initiatives Planning. The next step is to bring together teams that encompass personnel from several business units or support services groups such as IT, human resources, communications, and marketing. This interdisciplinary approach is necessary to identify and address the challenges facing the combined institution. Communications specialists should help decide on the appropriate channels to deliver messages to each stakeholder, whether internal or external. IT participants on these teams should be looking for

ways to develop or adapt applications to support the integration and eliminate gaps in products and services. As in the previous stage, teams are required to detail their plans and map interdependencies.

7. Execution and Tracking. A program office should be the mechanism for centralized coordination and control. It must work with both business and functional units to attack crucial topics during execution, including staff assessment, training, systems development and migration, and tracking of results. Integration teams should monitor progress against detailed charters through a tracking system that is continuously updated by business and functional work teams. In the IT arena, a number of simulations must be performed to ensure reliability before the acquired firm or division makes a final migration to the acquirer's systems. These typically include tests of a subset of branches (in the case of a bank) or of a geographical area (in the case of an insurance company).

Due diligence teams must understand new market segments, growth trends, the skills and capabilities of the target company, and the fabric of the competitive landscape.

CHOICES AND TRADE-OFFS

For each aspect of an integration program, there are a series of options to choose from (*see Exhibit 3*). The overall design of the program is determined by the combination of these options. For example, if the pace of integration cannot be deliberate—perhaps the competitive landscape is so challenging that the

newly integrated company must move rapidly into full operations because customer retention is at stake—it may be impossible to seek 100 percent of the answers during the early stages of due diligence and planning. In those cases, 80 percent of the answers, as shown in the second line, will have to do.

Exhibit 3
Integration Options and Trade-offs

Integration approach	Selectively integrate	Take over, absorb	Best of both	Transform
Integration pace	Get 100% answers and agreement		Faster is better (80/20)	
Role of integration leader	Progress monitor	Process manager	"Integration leader"	
Integration decision making	Bottom up, decentralized	Regional/BU led	Top down, centralized	
Source of value creation	Cost reduction	Revenue	IT/Ops transformation	
Opportunity prosecution	Conservative		Stretch, fast-paced	
Formal structure, processes, and systems	Keep separate	Hybrid by BU	Choose 1 of 2	Create new
Leadership and employee selection	Acquiring team dominates	Dominant team by BU/geography		Best team
Retention	Passive, selective		Active, targeted	
Intervention in informal/cultural change	Passive, reflective		Proactive	
Desired culture	Coexistence	One dominates	Geography/BU led	Craft new culture
Communication style	Only facts and decisions		Incl. open points, integration status	

Source: Booz & Company

GETTING IT RIGHT

Even with the best intentions, companies may be overwhelmed by the details involved in a successful postmerger integration. Three distinct operational activities must be aligned: governance and integration structure; planning; and execution and result tracking. For each of these areas, companies that fail to integrate acquired firms properly tend to suffer

common pitfalls. For example, they may overlook the need to establish dedicated structures and teams to manage the integration. Or they may neglect at first to clarify the strategic intent and objectives of the integration process. We offer a checklist of typical mistakes that companies make in postmerger integration and best practices for avoiding them (*see Exhibit 4*).

*Exhibit 4
Pitfalls and Best Practices for Postmerger Integration in Financial Services*

	Typical Pitfalls	Best Practices
Governance and Integration Structure	<ul style="list-style-type: none"> • Structure work poorly • Fail to establish dedicated structures and teams for key efforts • Deploy suboptimal team to handle integration effort • Let the magnitude of the challenge distract team from tactical activities (e.g., Day One) • Provide dedicated teams with limited decision rights 	<ul style="list-style-type: none"> • Provide dedicated structures • Implement centralized coordination and control • Deploy multifunctional groups • Select most adequate people
Planning	<ul style="list-style-type: none"> • Fail to clarify the strategic intent and objectives right up front • Let functional fronts drive the integration agenda 	<ul style="list-style-type: none"> • Adequately define strategies and objectives • Implement fast decision making • Continuously assess risk and deploy contingency plans • Define methodology for tracking financial results • Assess up front the pros and cons of different integration strategies
Execution and Result Tracking	<ul style="list-style-type: none"> • Develop methodologies and tools/templates during integration • Integrate organization using an inward-looking approach • Display lack of discipline in achieving synergies 	<ul style="list-style-type: none"> • Use extensive preparation for migration • Communicate frequently with clients and internally • Develop equitable employee assessment methodology for both institutions • Follow up on post-migration activities

Source: Booz & Company

CONCLUSION

Merging two distinct organizations, frequently with quite different cultures, has always required a disciplined approach with a dedicated structure. But today's environment is more demanding. As banks, insurance companies, and other financial services enterprises assess their acquisition opportunities, they need to ask themselves whether they have the necessary capabilities and proven processes to integrate firms in the most streamlined and efficient manner. Past experience

in a less complex era may not be sufficient. Nor is experience in rollups totally transferable to a much larger merger of equals. As challenging as today's climate may be, it clearly represents historic opportunities for the survivors and consolidators. Financial institutions that can take advantage of M&A opportunities and also integrate the acquired firms in a thoughtful and value-preserving manner will emerge as strong players in what shapes up as the industry's end game.

For more information on this topic, please visit www.booz.com/mergers.

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