

Getting IT Right after M&As

A slew of shotgun weddings are being consummated between banks in the aftermath of the global meltdown. Wells Fargo has bought Wachovia, JPMorgan Chase got its teeth into Washington Mutual, and Bank of America snapped up Merrill Lynch - just three among several couplings.

Dictated by the needs of market consolidation, competition, globalization, and regulations; cash-strapped sellers, bargain-hunting buyers, and interventionist governments are buying into a new future through rapid-fire mergers and acquisitions (M&As). In fact, governments around the world gobbled up \$242.5 billion of stakes in financial institutions in October. Finance M&As in the US totaled \$180 billion.

There has also been a dramatic acceleration in the speed at which mergers take place. The average duration from transaction announcement to completion dropped to 80 days in 2008 from 142 days in 2007. Mergers will continue as banks look to take one giant step in growth, or just want to rationalize and survive the credit crisis.

It is true that M&As can deliver a number of benefits, from a cost advantage to a larger customer base, and from new products and economies of scale to access to more geographies. But mergers – especially speedy mergers to buy competitors at bargain basement prices – are fraught with challenges and risks.

Mergers throw together two differing structures, systems and business cultures, and scare employees and customers. They lead to a complex business environment plagued by disparate processes and revenue leakages. Above all, a merger creates a potentially disjointed IT landscape. The merger may come to naught if technology cannot be leveraged for profit, which may well be the case if a patchwork of processes, products and IT paralyze the merged entity.

When merging, banks must reconcile all aspects of business to deliver success. Key to such reconciliation is integrating multiple technologies of both organizations and aligning the consolidated IT setup with synergized business goals. This often presents the biggest challenge to realizing the value of a deal.

What are the imperatives of such synchronization? How can a bank ensure that its merged IT environment has the agility, flexibility and scalability to meet the challenge of the times? To ensure that the wedding does not lead to an unhappy marriage, banks need to focus on streamlining their technology strategy in the integration process along the imperatives discussed in this paper.

The Action in APAC

The wave of financial mergers taking place in the wake of the global financial meltdown is also having a ripple effect in the Asia-Pacific region. For example, the Australian government approved the \$18 billion merger of Westpac and St George Bank to enhance the competitiveness and stability of the country's financial system.

Taiwan's smaller banks are under pressure to consolidate, giving the financial regulator a great opportunity to enforce mergers. And of course, it was Mitsubishi that inked a \$9 billion deal with Morgan Stanley.

However, the region saw a spate of M&As even before the current financial rumblings, with 220 deals worth \$70.5 billion during the first eight months of 2007, up 40% from \$50.5 billion through 197 deals in the previous year. Japan led the tally with 72 deals valued at \$36.3 billion. South Korea came in third with 10 M&A deals valued at \$7.6 billion.

In 2006, M&A volume in the sector had soared 96.1% to \$30 billion over 2005 figures, according to a leading Asian financial publication, driven by market consolidation and capital-rich banks buying stakes. India and China saw the greatest number of deals at 29 and 24 respectively. Banks in Australia, Hong Kong and Singapore were the most active in cross-border deals.

Banking consolidation in the APAC region gathered steam from 2001. It was regulation-driven in South Korea, with the government promoting consolidation to face the non-performing assets/ loans (NPL) problem. Japan's

financial powerhouses were the creation of mergers too. Mizuho Financial Group was created in 2003 by merging Daiichi Kangya, Fuji Bank, Industrial Bank of Japan, Yasuda Trust Banks. Mitsubishi Tokyo Financial Group was created in 2002 by merging Bank of Tokyo Mitsubishi, Mitsubishi Trust Bank and Nippon Trust Bank. UFJ Group was created in 2001 by merging Sanwa Bank, Tokai Bank and Toyo Trust & Banking.

Recent banking consolidation in Malaysia and Indonesia is a result of the crowded marketplace in the countries. A huge number of private banks became unviable since they were vying for a small slice of the business pie. Accordingly, many Indonesian banks are now owned by international banks and development finance institutions, and investment arms of countries like Temasek Holdings of Singapore.

Similarly, many international players have bought stakes in APAC banks. The four largest Australian banks have invested heavily in banks in South East Asia, South Asia and China. Many large European and US banks have also made major investments in China starting in 2003-04. HSBC, Standard Chartered and Citigroup have all acquired smaller Taiwan banks in the past few years.

The biggest challenge for banks going in for M&As in this region is the NPL level across banks. Many banks are weak in capitalization and have capital adequacy ratios far lower than what regulations dictate. Japanese banks have seen massive restructuring and capital infusion by the central government to bail them out of the high-NPL-low-credit crisis. China plans to handle the huge NPL levels with foreign funds. The only way to do this is by inviting investments from foreign banks by selling stakes – thus setting in motion another round of M&As.

Globalization and Standardization

Competition is brutal, margins are low and customers want everything and more. The quest for sustainable growth in a challenging environment is pushing banks beyond geographic boundaries. Many banks are striving to become either regional or global leaders in a race for cheaper funds, greater scale and bigger profits.

And with the centre of gravity of global finances shifting to accommodate the growing wealth of emerging economies such as China, India and the Gulf states, banks such as Santander are fast making their way to these shores to increase their customer base and revenues.

Often opting to extend their footprint through M&As in crowded developed or emerging markets, local banks are becoming regional and regional ones are growing into global players. Even smaller banks are compelled to react to global players entering the market by consolidating with other institutions.

With diverse customers demanding tailored products at a low cost and multiple product channels, banks have varied products and services on offer. When merging, a bank must analyze the offerings and standardize similar products and services across both organizations. By doing so, not only will it ensure simplicity and manageability in its new portfolio, and competitiveness and efficiency in its operations, but also retain the customer base.

Thus, the core banking application chosen by the merged entity must support the standardized products and services. It must also take care of customized products offered by either of the banks. If it does not, the combined bank is left unable to satisfy the needs of its customers. Thus, the integrated core banking platform must be highly parameterized and agile so as to define the features of all bank offerings, remove duplications and leverage economies of scale.

Rationalization and Process Orchestration

The merged entity needs to integrate its IT landscape, its approaches, products, business models, processes, customer knowledge... all the wide-ranging components that help a bank function as an effective whole.

To become business ready, the new bank must rationalize its operations according to geographical reach, delivery channels and manpower. These need to be right-sized in accordance with the imperatives of the merged

bank. For example, branches may have to be shut down or pared in function and the affected employees rehabilitated with new skill sets.

Such rationalization must include the offshoring and outsourcing activities of the concerned banks. Employees must also be empowered with knowledge about the functioning of the combined bank to enable them to serve customers effectively. This is critical in boosting the morale of unsettled staffers who may fear losing their jobs.

Moreover, the merged entity must have unified and standardized processes up and running as soon as possible. Thus, while merging, a bank must choose the best processes across all delivery channels and entities in all aspects of business – from the back office to building trust from product offerings to treasury operations.

A bank must remember that the acquisition presents an opportunity for adopting best practices and it must take advantage of the unique products, processes, and skills that its partner may possess. An acquired bank need not convert to the acquiring bank's systems and processes. Rather, the bank must evaluate which entity has the best processes and decide which should be followed.

Disjointed IT results in operational complexity and redundancy, and leads to inefficiency, high costs and loss of productivity. A bank leveraging such a setup will never be able to enjoy the benefits of a merger. The combined entity needs a robust core banking system with the capability to handle the enhancement of processes that follow a merger. Moreover, it must be able to handle the best processes adopted by the merged entity. An integrated IT landscape with synergized processes allows the bank a 360-degree view of the customer, enabling it to target customer requirements and ensure a high level of service. There must be a single view of operations, risk and compliance, assets and liabilities, and the other necessary intelligence and management tools in a rationalized setup.

Customer Relationship Management

A bank is after all a business. And, like any business, a bank relies on its customers. Even as banks merge to extend their customer base and grab wallet-share, they need to ensure that they retain existing customers in the merged entity. Making customers happy by fulfilling their needs is directly proportional to ensuring their loyalty – customers who are satisfied with the bank will forge a stronger bond and make greater investments.

A bank must manage customer relations efficiently and effectively to prevent attrition. It must convince existing customers who feel threatened in a new entity that their needs will be looked after and that their money is safe. If need be, banks need to start educating customers on these aspects as soon as the deal is struck.

Today, customers want personalized products, and they are willing to switch their account to the bank that gives them a better deal. While merging, a bank must choose a core banking solution that enables it to satisfy varied customer requirements. It must also allow greater insight into the drivers of customer behavior to help a bank in right-selling.

Such a core banking system must be scalable to meet the needs of customers who come with the acquired bank. The system must also have the capability to handle the evolving needs of customers who may join later and take care of an ever-growing volume of transactions. The merged IT must address the needs of a growing volume of employees, products, services and data.

Software as a Service

It is evident that mergers demand large investments in IT infrastructure. In a time of competition and shrinking margins, lower investment amounts can make an enormous difference to the bottom-line. Thus, banks strive to cut costs to the greatest possible extent when merging to best enjoy higher returns on investment.

SaaS (Software as a Service) can give them what they are looking for – all the benefits of a merger at very low cost with the best technological framework thrown in. With SaaS, a bank need not buy the IT infrastructure or the framework software for a smaller combined entity. Instead, it can merely use a preconfigured ‘bank in a box’ software and hardware hosted as a service, paying a license fee for the privilege. An acquiring bank may choose to integrate the SaaS system at a later point in time.

A global bank can deploy such a solution across entities for dispersed operations and ensure a shared service model.

Conclusion

Banks need to keep in mind that business and technology are inextricably linked. Any business decision triggers an IT requirement. At the same time, IT can enable or disable a business objective. The mantra for merging banks is consolidation and integration of all areas of activity: from IT and systems to workforce, products, services, and processes.

This ensures that a merged bank enjoys a total view of its operations and marketplace and employs a holistic approach to take on challenges and run its business. A unified operation allows a bank to generate economies of scale and brings scalability, agility and greater efficiency. Customer strategy is integrated, as are the offerings and processes. Costs are reduced, transaction volumes increased and revenue gets a boost.

To enable this, banks require a robust and agile core banking system which allows seamless integration by helping a bank standardize and rationalize products and processes, and satisfy employees and customers.

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