Bank Mergers and the Critical Role of Systems Integration

With mergers and acquisitions (M&A) on an upward trend in the banking sector, institutions must focus on getting IT integration right to assure a successful result.

Executive Summary

Worldwide, mergers and acquisitions in the banking sector have become increasingly common. To compete more effectively and offset rising regulatory pressures, small and medium-sized banks are most likely to choose the M&A route – their principal objective being to reap the benefits of economies of scale.

Over the past year, we have seen many banks make strategic choices about what areas of their business are “core,” and simplify their operational infrastructure accordingly. As a result, institutions’ M&A activities will likely increase in 2015 and beyond – compelling banks to sharpen their strategies while focusing on areas that offer the best chance of boosting their capital.

In this paper, we will examine the factors that help determine the outcome of a bank merger, and discuss the role that IT integration plays in achieving a successful result. Finally, we will specify the steps involved in due diligence and planning, and lay out a process for effectively integrating and operating a bank’s IT landscape.

Introduction

Banks and financial intermediaries are increasingly consolidating through mergers. The reasons behind these activities can vary – from managing global enterprise risks and statutory obligations, to meeting regulatory requirements, to taking advantage of institutions’ synergies.

As banks move forward with mergers and acquisitions, they are tasked with integrating technologies from various areas within and outside the core business. Any glitches or disruptions during this process can negatively affect a bank’s reputation. It is therefore essential that banks work to mitigate exposures in areas related to interconnectivity, the market, regulatory compliance, credit (and collateral) quality, innovation and liquidity, for example. These risks can be mitigated through advance planning and due diligence to ensure a smooth transition.

Why Bank Mergers Can Fail

There are numerous examples of unsuccessful bank mergers. One of the most prominent is Bank of America’s acquisition of mortgage lender Countrywide in 2008, which cost the bank more than US$40 billion. The merger turned Bank of America into a big player in the mortgage market right before the housing bubble burst. Since then, the bank has suffered massive real estate losses and paid out huge sums in legal fees and settlements with state and federal agencies.
Some of the major reasons why bank mergers fail are:

- **Poor cultural fit.** If the merging banks are not able to overcome differences in their work cultures, the merged unit cannot function well as one entity.

- **Poorly managed integration.** Systems integration is a crucial factor that must be addressed very carefully. A failed effort can have a cascading effect on customers, as well as statutory and regulatory reporting — leading to confusion and potentially irreparable damage to a bank's reputation.

- **Failure to set the pace for integration.** The pace of integration of the merging banks needs to be planned meticulously and carried out quickly and efficiently to avoid the possibility of losing focus over time.

- **Incomplete and inadequate due diligence.** Due diligence by both bank businesses is critical in determining if the merger will actually yield beneficial results.

- **Failure to engage IT teams.** Many bank mergers have failed because IT teams have been brought into merger activities too late — compromising business continuity.

### Why Systems Integration is Crucial

Any glitches or disruptions to business processes during a merger can have adverse — sometimes disastrous — effects on a bank's reputation, including loss of customer trust and, as a result, lost business for the banks. The role that systems integration plays in assuring business continuity during and after mergers is critical — involving the integration of infrastructure components such as data centers, operating platforms and enterprise applications, and alignment of IT and business strategies of the merging institutions. Although the integration process normally takes two to three years post-merger, the impact of problems — loss of profitability and cost-efficiency, for instance — can last well beyond this period.

### Due Diligence and Planning

When it comes to bank mergers, the most important success factor is assuring the functionality of the IT infrastructure, which directly affects the customer experience. Hence, it is imperative that bank CTOs are involved in the planning of merger activities, including performing due diligence of both entities' IT landscape.

There are various scenarios related to the merging of IT infrastructures:

- The IT system of the principal entity is found to be robust, and can support the business of the **merging** bank.

- The IT system of the merging entity is found to be robust, and can support the business of the **principal** bank.

- The merged entity's IT infrastructure is a combination of both institutions' systems environment — the goal being to take maximum advantage of both. This is helpful when the business areas of both banks are different and the IT products are customized to suit each one's requirements.

- A new systems infrastructure offers all the necessary services to the customers of the merged entity.

To help ensure a successful merger from an IT perspective, the following points must be considered:

- Is it better to select one of the existing IT landscapes, or opt for an altogether new IT environment? The first approach will require less time and effort, since at least some users will be familiar with the systems. Also, the expertise is already there, and can be leveraged in the merger process to help save time and costs.

- Applications that together form a relatively integrated group should be identified across the merging entities.

- The selection process should take into account the application group that best serves the required functionalities — its cost; its training requirements; whether data from other applications to be phased out can be successfully migrated to these systems; and, finally, the degree of flexibility the application set offers for future requirements.

- The merging bank might have certain applications that are indispensable to sustaining a competitive advantage. A robust IT architecture should be flexible enough to incorporate those systems.

- The duration of any systems integration effort is an important consideration. The longer it takes for it to happen, the longer the merged entity must bear the cost of managing two separate infrastructures. At the same time, rushing such an undertaking can be counter-productive. Sufficient time should be allotted to achieve goals of the IT merger.
In the scenarios outlined above, the primary objective is to have a single IT environment that is used by all employees of both banks, since the use of a single IT landscape further strengthens the cultural integration of the merged institutions. Such an infrastructure can be a combination of the applications from both of the merged banks.

The main aim of an IT integration program is to make it as seamless as possible so that customers are not inconvenienced. Hence, when performing IT due diligence, CTOs must assure that all interfaces and delivery channels are thoroughly assessed.

Finally, the decision to take a particular IT path must take into account the following:

- The license fees and cost of the required infrastructure.
- The quality of data in the existing systems and the possibility of migrating that data to the IT environment that will serve the merged entity.
- The time required to migrate data from one system to another, without impacting regular business hours.
- The training required for users.
- The extent to which the customer experience will be affected post-merger.

**Execution**

For banks, the systems integration process should involve the following steps:

- Creating the IT infrastructure that is finalized for the merged entity.
- Planning and imparting training to users who will be operating the new IT environment.
- Data and product mapping of the merging entities to the new system.
- Identifying the time window when the actual migration will take place – preferably over a weekend or an extended weekend – to ensure business continuity.
- Testing the migrated data before go-live and arriving at a go/no-go decision.
- Ensuring that all delivery channels are functional post-migration.
- Updating business-continuity and disaster-recovery plans for the merged entity.
- Ensuring regulatory, statutory and legal compliance.

Customer communication is a key part of the systems integration process. In most IT integration activities, customers’ contact and account information, login IDs and passwords undergo some type of change. The best way to handle this is to convey those changes to customers in advance. The timing of these communications is of utmost importance, and must be determined early on.

The actual process of integrating systems must have checks scheduled at regular intervals to ensure that the infrastructure is ready for deployment, the users are sufficiently trained to handle the new system, the migrated data is correct, all reports are being generated, and all the delivery channels are operational post-migration. It is equally important that customers and end-users have all the information they need to use the banking services as usual, without interruption.

**Conclusion**

There is no denying that systems integration is one of the core components of bank mergers. To ensure a smooth transition, institutions must be mindful of the following:

- The IT department should be involved from the very beginning of the process.
- The IT integration strategy should be aligned with the business strategy to ensure a successful merger.
- Due diligence of the IT systems is of utmost importance.
- IT teams should be brought in during the early stages of planning, which should place special emphasis on IT integration.
- Effective risk management, including business-continuity and disaster-recovery plans, should be in place.

The main aim of an IT integration program is to make it as seamless as possible so that customers are not inconvenienced.
About the Authors

Parag Gaikwad is a Senior Consultant with Cognizant’s Banking and Financial Services’ Business Consulting Group. He has more than 13 years of experience in banking and IT, mainly in the corporate banking and trade finance domains. He can be reached at Parag.Gaikwad@cognizant.com.

Rajdeep Bhaduri is a Lead Product Consultant and Senior Manager with Cognizant’s Banking and Financial Services’ Product Solutions and Applications Group. Rajdeep has more than 15 years of experience in leading business and IT engagements, mainly in the private banking and capital markets domains. He can be reached at Rajdeep.Bhaduri@cognizant.com.

References

http://online.wsj.com/news/articles/SB10001424052702303561504577495332947870736
Integration and Information Technology Effects on Merger Value in the U.S. Commercial Banking Industry. Ali Tafti College of Business, University of Illinois at Urbana-Champaign, 350 Wohlers Hall, Champaign, IL 61820.
http://en.wikipedia.org/wiki/List_of_bank_mergers_in_the_United_States
http://dspace.mit.edu/bitstream/handle/1721.1/35101/71356376.pdf
http://www.bis.org/review/r000721b.pdf

About Cognizant

Cognizant (NASDAQ: CTSH) is a leading provider of information technology, consulting, and business process outsourcing services, dedicated to helping the world’s leading companies build stronger businesses. Headquartered in Teaneck, New Jersey (U.S.), Cognizant combines a passion for client satisfaction, technology innovation, deep industry and business process expertise, and a global, collaborative workforce that embodies the future of work. With over 75 development and delivery centers worldwide and approximately 199,700 employees as of September 30, 2014, Cognizant is a member of the NASDAQ-100, the S&P 500, the Forbes Global 2000, and the Fortune 500 and is ranked among the top performing and fastest growing companies in the world. Visit us online at www.cognizant.com or follow us on Twitter: Cognizant.