MANAGING THE IS FUNCTION DURING MERGERS

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ABSTRACT

This paper reflects on the role of the IS function during mergers. It is based on three European mergers cases. The paper then looks at the process of merger management and the issues and inhibitors that this entails for IS. The IS implementation strategy and the process by which IS may facilitate the merger and enact its own integration is considered. Finally, lessons for management are drawn.

1. INTRODUCTION

Mergers are an established feature of the industrial landscape, valued at up to $2.4 trillion p.a. Most are failures, 60-80% are financial failures, and 2/3 destroy shareholder value (Tettenbaum 1997). Business Week (1995) reports mergers hurt more shareholders and firms than they help. Yet there are some successes and hence it is critical to understand the factors that determine the difference between long-term success and failure. Mergers create significant trauma for both firms as mergers differ from other change processes in rate of change, scale of change and critical mass of the unknown (Marks 1988).

There is a vast literature on the financial and legal aspects of mergers. There is literature on human resource issues but little on IS (Johnston and Yetton 1996). This is surprising, as IS is more strategic and important than previously, and acquisition to obtain technologies or systems is commonplace. There are mergers to procure IS or Internet activities and those that fail due to incompatibility of the firms' IS. The trend is for mergers to be driven more strategically, by technology, globalisation (Marks 1997) and to involve larger firms. Other drivers include industry consolidation, scale economies, cost savings, high liquidity and regulatory changes (Balmer and Dinnie 1999). In Europe EMU drives some mergers. While Marks (1997) suggests managers are getting better at mergers, in part due to experiences of BPR and downsizing, most fail due to:

- Undue attention to short-term financial and legal issues

- Inadequate recognition of leadership issues

- Failure to secure goodwill of stakeholders

- Dominant players giving little attention to culture

- Little recognition of conflict between individual and corporate objectives

- Poor corporate communications (Balmer and Dinnie 1999)

Note there is no mention of IS.

The lack of post-merger success is increasingly attributed to human factors, the integration of distribution systems and IT. Lawyers and accountants who focus on anti-trust concerns and share offerings dominate the pre-consolidation period. There is a dichotomy between deal making and integration – attention is front-loaded on the deal and only after agreement and due diligence does attention shift to planning integration of policies, systems, structures, people and culture (Tetenbaum 1999). Buono describes a merger begun in the spring, but IS issues were not considered until December. Further, middle managers who will eventually run the business are rarely involved in the acquisition negotiations and integration planning (Risberg 1997).

Firms are good at pre-deal skills but poor at planning and integration. Successful acquisitions depend on a pre-acquisition analysis of fit - the match between administration, cultural, and personnel characteristics (Sisaye 1998). Fit requires analysis of hierarchy, structure, rewards, tasks, decision-making, and centralisation. There is a need for structural match in terms of leadership, personnel, resources, and systems. Last, a long-term approach to mergers is better (Balmer and Dinnie 1999).

Mergers impact significantly on firms and people. Mergers transform structures, cultures and prospects so that employees feel stressed, disorientated, and confused (Buono 1997). This results in lower commitment and productivity, increased dissatisfaction, high turnover, and power struggles. Tetenbaum (1999) adds disrupted work processes, customer defections, and diminished investor confidence.

This paper presents reflections on the role of the IS function during mergers. IS activities pervade all aspects of post-merger integration and the focus has to go beyond the IS function to consider all business integration activities. It is based on three European merger cases in the insurance sector in which one author had insight. It might best be described as participant observation. The three cases are augmented by a fourth, published, case that illustrates a different set of issues. This research is exploratory; there is little published research on the IS role in merges and acquisitions and no theoretical base with which to sensitise the case results. First, the paper gives brief case vignettes to provide background. It then looks at the process of merger management and the issues and inhibitors that this entails for IS. This section considers some general business lessons. Then the IS implementation strategy and the process by which IS may facilitate the merger and enact its own integration is considered. Finally, lessons for management are drawn.

2. CASE BACKGROUND

Example 1: European banking/insurance merger. Here, the priority was to create a single product set by building new products on a new strategic IS platform. There was no data conversion, so business was manually rewritten on the new products at renewal. Some tactical rebranding of branches was undertaken but no early rationalisation. This left branch technology reflecting the old firms' different technical platforms, though all branches could access the new platforms. Cultural issues figured significantly.

Example 2: European insurance merger. Here the biggest benefit was cost saving, stemming largely from branch rationalisation. The merger involved rapid product rationalisation by discontinuing products and rationalising 100 branches to 50. Some previously separate business areas were taken into branch operations. There was a new operating structure and staff roles. New branch technology accessed both firms' legacy systems through a common desktop. There was no move to consolidate separate data centres. While current

products are serviced by the legacy systems, future products and systems are being built on a new strategic IT platform, but the migration timetable extends well beyond that of the merger. The significant savings were in people, premises and IT costs.

Example 3: European insurance merger. This merger involved an extended period of operation without product or branch rationalisation resulting in unintended competition between products and branches. The physical data centres were consolidation but they still run multiple logical environments, hence the applications and the data are still separate, so many IT costs and flexibility benefits were not achieved. Culture differences also impeded progress.

Example 4: Australian Bank merger. Here, the acquiring bank was much larger, but the more flexible IT operation of the acquired bank offered a potential competitive edge. Hence a 'best of breed' approach was attempted for IT. This was unsuccessful and a year later was abandoned and an 'absorption' approach taken as the only way to complete in a reasonable time-scale. This was undertaken rapidly and achieved savings, yet the best aspects of the acquired bank's operations and technology were not assimilated (Johnston and Yetton 1996).

3. MANAGING THE MERGER

In managing the merger, senior management has choices in implementation strategy and phasing. The big problem is managing the post-implementation process. Executives underestimate the magnitude of integration issues and problems, the drain on resources and distractions from performance required to manage the transition, and the pervasiveness of human issues (Marks 1997). Figure 1 shows the factors influencing the approach to integration as discussed next.

The approach to managing the merger depends on the objectives - cost savings, market share, technology, R&D, markets, branding, and size. In cases 1 and 2 the firms obtained the desired results but the objectives were not extensive. Savings arise from eliminating duplicate activities, improved operating efficiencies, and moving to a single system. However, goals may also be irrational, or emotion-driven. In mergers the ascendant firm seeks to demonstrate its authority (Lowe 1998). The starting point is the firms' relative sizes, any pre-set dates to satisfy shareholders or regulators, expectations of further mergers/disposals, past merger or escape experiences, and closeness of fit.
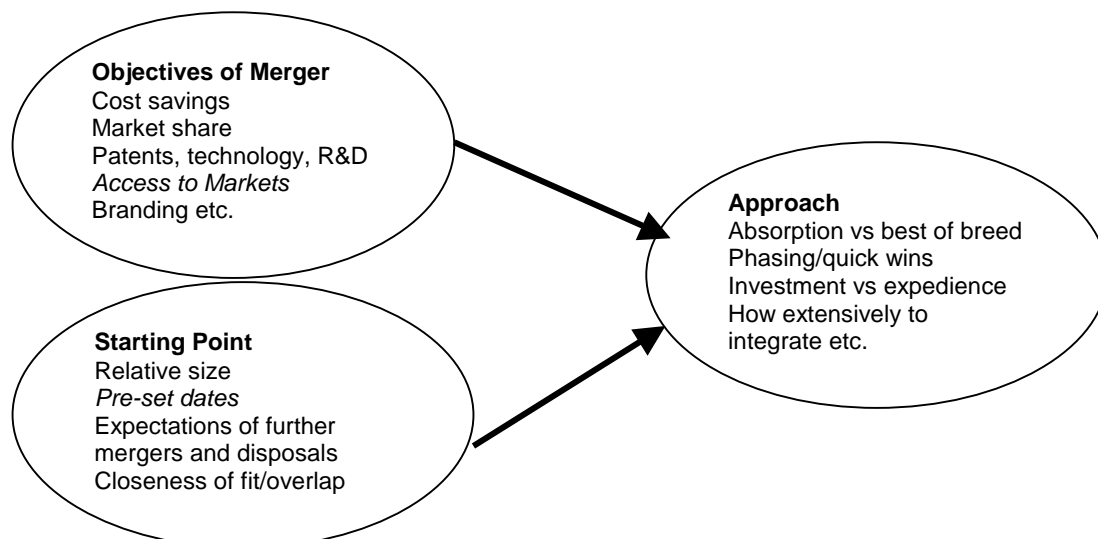

Objectives of Merger
Cost savings
Market share
Patents, technology, R&D
Access to Markets
Branding etc.

Starting Point
Relative size
Pre-set dates
Expectations of further
mergers and disposals
Closeness of fit/overlap

Approach
Absorption vs best of breed
Phasing/quick wins
Investment vs expedience
How extensively to
integrate etc.

Figure 1: Factors influencing the approach to integration

The approaches available include absorption versus best of breed, phasing versus quick wins, investment versus expedience, and the degree of integration required. The problem is most acute in matched firms as

there is no a priori target model, though there is no agreement as to whether size differences affects success (Bourantas and Nicandrou 1998). The merging parties may not be stable themselves. They may not be fully rationalised or integrated from previous mergers or other transformations. Mercer Consulting suggests that failure is largely explained by absence of an integration plan. Post-merger management policies can improve success by 50%. Of the available synergies, 30% are typically realised, 55% ignored or forgotten, while 15% are ill-conceived, failed or abandoned.

The merger rationale determines the need for integration, its objectives and drives the integration strategy. It may be easier to absorb one firm but this loses the benefits of pragmatically choosing the 'best of breed' and may not be an option for similar sized firms. Choices in product rationalisation include whether to rationalise and pragmatic selection against a longer term, strategic view. If the acquirer bought a brand, niche firm or into a new market there may be no case for integrating. If there is high product/market overlap then the benefits are from cost savings, only realisable by integration. Total integration though is not always best – often the acquired firm is forced to change unnecessarily (Risberg 1997).

Decisions on the extent of rebranding must to be taken such as rebadging, re-branding, re-naming - each differs in benefits and costs. If the acquired firm has a strong brand then it would likely be kept.

Management needs to consider whether integration can be combined with other business or technical initiatives. For instance, a new product set, or IT platform can be a vehicle for integration but often time-scales or complexity renders this impractical. One case firm successfully incorporated a new branch IT platform but decided that introducing a future application platform as part of the merger would be too much for users to cope with simultaneously.

Migration to new IS can be electronic or manual, on-renewal or by 'big bang'. The trade-offs depend on volumes, product number and complexity, and, crucially, data quality. There are difficulties migrating everything mid-term. Decision factors include the manual effort to re-key versus the IT effort, quality of existing data, potential for loss of data (such as claims history), and skewed management information if renewals are re-keyed as new business. There may also be legal and technical issues in developing a single database if the firms have different client privacy agreements.

The chosen strategy is not always optimal for the long term. Often over-riding short-term considerations drive initial management actions. For example, there may be constraints on implementation such as budgets or fixed delivery dates. Some dates may be self-imposed, such as those for payback. One case merger deferred application rationalisation, as it could not deliver within the year allowed for merger savings. There may also be limits on transient costs, resources or skills.

The IS function is crucial from the outset. There is an immediate need to rapidly present a single external interface. This usually involves a quick lash up of an integrated front to customers, channels, and suppliers. These front-ends camouflage multiple legacy systems working behind the scenes. This earns IS time to do real integration. There is a need to retain key skills during the merger, yet they may not be wanted beyond. Such constraints may necessitate phasing or progression in manageable steps. However, quick wins are important to gain the confidence of staff and partners. Project management skills are paramount as there are many small-scale but vital projects needed quickly.

4.   KEY ISSUES AND INHIBITORS

A number of inhibitors impede the merger. First is organisational paralysis that impacts all decision making and change initiatives, but especially integration due to:

- Unclear roles and authorities

- Interpersonal/ego conflict

- Unclear business priorities

- Two sets of processes/rules/authorities

- Disaffected staff

- Difficulty of seeing the big picture and the next steps

The second inhibitor is the clash of cultures. This is often the biggest impediment and invariably underestimated. The merging firms have different ways of working, value systems, and corporate lexicons. This impacts on integration as new heterogeneous teams try to work out the rules for working out the new rules. The BIM (1996) states 'the major factor in failure was underestimation of difficulties merging two cultures'. There are three perspectives on cultures in mergers (Martin and Meyerson 1991). The integration perspective suggests members of the combined firms deny their differences. The differentiation perspective stresses the inconsistency in the cultures – it views culture as either harmonious or conflicting. Participants refuse to find similarities and emphasise subcultures. Consensus flourishes within the sub-cultures but not between. Finally, the ambiguity perspective suggests cultures are not clearly consistent or inconsistent. Culture is viewed as fragmented, consisting of many subcultures and ambiguity is acknowledged. This leads to misunderstandings and breakdown in communications that can threaten goals (Risberg 1997).

Mergers are a time when power politics are writ large. Senior figures critical to driving the integration are often pre-occupied with their own prospects. One approach is to link executive compensation to the merger goals. Retention of key people and skills during the integration, but possibly not beyond, presents the next inhibitor. Staff who implement the changes include those who are disadvantaged by it through job loss, relocation, or decline in status. Key staff may leave or cease to be effective and fear, denial, or subversion are not uncommon. Other effects include uncertainty, anxiety, stress, low morale, decrease in satisfaction and commitment, unproductive work time, error rates and absenteeism, even sabotage (Bourantas and Nicandrou 1998). Workers suffer from change weariness – most are larger and take longer and more resources than planned (Marks 1997). Completion bonus payments may ensure the work gets finished. Cooper & Lybrand (1995) demonstrate an increase in firms offering retention bonuses from 14-43%. Further, the way terminated employees are treated during the downsizing and are supported afterwards has a dramatic effect on survivors' attitudes (Tetenbaum 1999).

Most merger failures boil down to people issues. 75% of firms fail to place employees in the right roles after merger. Employees experiencing a merger are expected to absorb a monumental change while simultaneously continuing to maintain a high level of productivity (Tetenbaum 1999). Thus, management needs visibly to provide job security, offer outplacement assistance, and perhaps maintain the autonomy of existing firms (Sisaye 1998).

A key issue is trust - only 20% of employees trust what senior management tells them – trust is usually assessed informally (Lowe 1998). Communicated information reduces ambiguity but false information can increase it, 'one of the worst things the acquiring management can do is to wait and see, to take no action after the acquisition' (Risberg 1997). Trust is not helped by changes in reward systems that cause ambiguity of success – behaviours valued before the take-over that are no longer rewarded. Leavers take away not only cumulative knowledge about the firm but also about the acquisition process (Risberg 1997).

Many mergers are subject to intense media scrutiny. The merged firm must meet market expectations and keep its confidence. Expectations are generally high and specific targets may have been set when 'selling' the merger to shareholders and the market. These now become constraints. Yet, while the changes proceed the business must be kept running. The initial integration period provides a window for competitors to steal customers. This state has potential business controls exposure, as there are few rules and fewer checks. There is a massive impact involving relocation of functions, resources allocated to integration (including key staff), an internal focus by management, and new working relationships. Competitors may poach staff, customers and key intermediaries and the risk of fraud or malicious damage will increase.

The first steps of any merger require a significant percentage of the infrastructure to be in place. This has to be done quickly and the cases suggests that management needs to:

- have clear criteria for staff selection – openness of process and of appeal process. With two systems for appraisal, it may prove difficult to ensure equity. However delays have a huge impact on IS as it defines the user population.

- run a pilot allowing time to evaluate outcomes and build learning into rollout plans.

- ensure early wins - important for morale and credibility. They lend tangibility and help unfreeze staff.

- manage the different human resource regimes. This involves objective setting, appraisal; the qualities rewarded often differ (the 'right' balance between initiative and conformance). An internal communications project and lots of training is needed.

- understand cultural issues. Culture clash will manifest itself in unforeseen ways.

- recognise the role of unions. Unions and local politicians take an interest in jobs – especially if the firm dominates the region.

- work on firm renaming. Renaming can involve: rebadging, trading names, and registered names. The synchronised release of different documents against the business cycle needs a complex plan.

- keep talking to customers and especially identify key relationships

- provide an early definition of key positions and authorities. This involves freezing most no-integration projects. But the impact of a capital freeze may be severe.

5.   IMPLEMENTATION STRATEGY – PLANNING FOR THE BENEFITS

The rationale for the merger drives implementation goals - usually cost-based. For service firms, cost is people, premises and IT. The first step in the implementation strategy is a quantitative business model for achieving the target benefits. This involves a model for cost savings, a design for the future state, benefits realisation, and an implementation plan. This is done by modeling the future state in terms of business units, modeling the future state for one unit, modeling the transition process for a unit and designing a transition plan for the whole. This highlights that if savings cannot be demonstrated they are unlikely to be achieved. The implementation project focuses on delivering the changes. Articulating the future state design is a critical step that links target setting to the implementation plan. This need not be the long-term future, but the one intended by the end of the integration phase.

5.1.   Implementation Examples

Implementation involves internal audit, communications, HR, unions, and the legal function. The degree of integration, pace of change implementation, participation in the process affect success (Bourantas and Nicandrou 1998). Staff selection is at the leading edge and requires clear criteria, meaningful in both firms' value systems. A core team with representatives from each function is best to facilitate the overall plan and manage interactions between functions. GE, which averages one merger a month, suggests that mergers without integration managers fare less well than those with. However, each location/unit needs its own view that cuts across functions. Hence, the outcome is a matrix with local teams and local end-to-end plans for each unit. These 'virtual teams' need site leaders who are also part of the core team. There needs to be a timeline for each local team working with the project team. The most successful transition teams are those that are given clear deliverables, but allowed to develop their own process. Deliverables extend beyond a mission, timetable and financial targets and into the core of strategy synergy. That is, transition teams must be charged with finding opportunities and recommending synergies (Marks 1997). 'Unfortunately, even when pre-merger planning teams are put into place, experience indicates that they are disbanded too early' (Buono, 1997). Table 1 shows sample elements from a general insurance merger.

Creating and managing the business model could be treated as an additional workstream. The model sets staff numbers, locations etc that the project plan then implements. Many intermediaries such as brokers have

relationships with both firms but on different terms. In one merger case, the training need was seriously underestimated and the consequence severe. For management information, typically firms have fundamentally different definitions for items such as class of business or profit. Producing a meaningful overview is difficult and not just an IT remit. Figure 2 shows the six forces driving actions at this stage.

The business integration strategy drives and constrain IS. Decisions about products, locations, and channels determine the target future state and set the constraints (resources, dates, and overall complexity) on IS. Since the business model is designed rapidly and implemented quickly, requirements are inevitably not available until immediately before delivery is needed, despite the long lead-times on many elements of IS, implying that flexibility in systems and delivery processes is paramount.

Workstream	Purpose
Customer/channels	Map intermediaries to new branch territories.
	Harmonise terms and conditions, invoicing etc.
	Consolidate duplications in management information
	Identify key relationships for special treatment
	Identify and produce client communications
Product	Rationalise product set and branding
HR	Manage downsizing and redeployment/termination. Implement common terms, conditions, rates. Trade union relationships. Culture change.
Premises and logistics	Acquisition, disposal and modification of premises to support new design, including leasing/rental. Manage building work cabling, telephony, office fixtures
Business processes	Identify, document, and implement process change or harmonisation. This defines many requirements on IS/IT. Ensure internal/external audit satisfied with business controls
IS/IT	Implement IS/IT changes to support business changes. Address IS/IT rationalisation opportunities to reduce IS/IT costs
Training	Identify, design and deliver training in business process and technology. Measure effectiveness. Provide first level Helpdesk during implementation
Management Information	Define and implement useable management information for merged operation

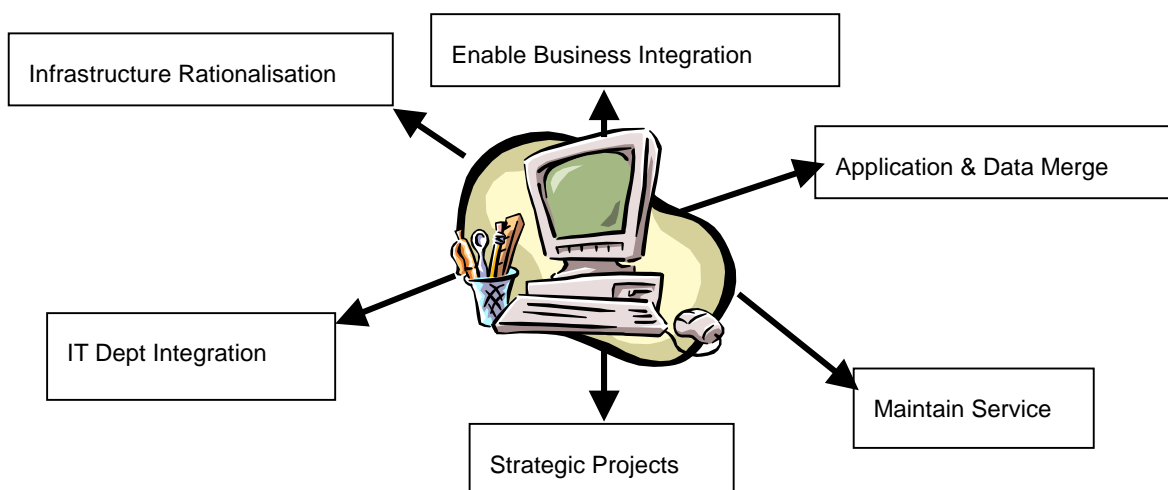**Table 1:** *Implementation Example from Case Merger*

Figure 2: *Six Irresistible Forces Impacting IS*

6. IT INFRASTRUCTURE RATIONALISATION

IT infrastructure rationalisation involves the technical solution, decommissioning/disposals, people and skills. licences, leases, support contracts, premises, and the cut-over plan.

The technical solution covers areas such as the data-centre, network, printing and distribution, desktop/client strategy, application architecture and disaster recovery. The applications and data side may yield the biggest savings (licenses, application support, and the number of logical environments). However, there are forces that drive costs higher. Software vendors may press for increased license fees as the original terms are exceeded. Licenses, outsourcing contracts, equipment and leases may have significant remaining duration.

The people and skills issues involve relocation, separation, re-skilling and entail human resources, unions and legal protection of employment rights of those transferred. The firm is dependent on people who are impacted or displaced. Especially now, IT staff have many outside options. Last, there is the 'bubble headcount' - while eventually the headcount will fall, more people are needed to facilitate integration. Hence a steep ramp-down occurs with extensive use of contractors. The firm may need additional skills, especially project management and technical architects.

During the early stages of integration the network load is hard to predict, as parts of the business relocate. Further, the diversity of desktop solutions (terminals, emulators, productivity software, LANs) can impact mainframe application access, support contracts, helpdesk, standard catalogue, and skill requirements. Even consolidation of inventories is not trivial.

6.1. Data and Applications Merging

Data and applications merging is often the difficult part of IS rationalisation, but can yield substantial benefits. Merging is critical to business flexibility and cost savings but takes time and the benefits are back-end loaded. If data and applications merging is put off then the firm may be unable to address new business initiatives due to the complexity of implementing them across multiple systems. Savings include application support, licenses, multiple environments, training and support.

The IS function is dependent on the business for decisions, agreements and concessions, process and document change and resolving resource conflicts with integration priorities. The business has to agree the conversion rules (as target systems differ from source systems) and to some loss of functions. They must also agree to significant change-freeze periods and provide resources for user testing and acceptance.

The technical risks in data migration include source date quality, system resources/downtime to build, test and run conversion, unknown performance impacts on target systems, and maintaining internal and external interfaces.

The processes involve mapping the product and process from migrated to target systems. Some critical functions may need adding to target systems, and user agreement gained to remove non-critical functionality. After building conversion programs, testing is needed. Usually it is pragmatic to phase the cut over with the normal business cycle and it may be lengthy. Then, decommissioning adds further time and may be delayed if the outgoing application has interfaces. Additional complications and delays ensue where business partners have access to decommissioned systems. Benefits only accrue when the last application using a particular subsystem is removed. Some systems are easier, others much harder especially where business products and processes are ingrained in applications. However, most integration efforts focus on formal systems and processes and ignore the informal (Tetenbaum 1999). Table 2 shows sample project elements enabling integration from one case.

In enabling business integration, requirements management is pivotal and there are huge training needs. The new operating and accounting structures must be reflected consistently in both legacy systems. In insurance this includes mapping agents, claims handling, and support functions onto branches and other business units. This may necessitate enhancements, extensive table changes, agreed workarounds and huge data reconstruction. A typical requirement is to give any user (from either firm) access to any application on any

platform/data centre, from any location. This requires a complex mix of terminal types/emulators. There is massive workload in developing new security profiles, as most staff have new roles and customer sets, and need access to both legacy systems. There is a need to ensure timely removal of departing staff.

New firm structure	Map legacy systems to new operating and reporting structures and re-make historic data
User access	Technical infrastructure to allow access. New access profiles to reflect new roles. Software licensing
Location moves/consolidation	Support premises consolidations/disposals with LAN/WAN, local server-based applications, infrastructure and telephony
Product/brand rationalization	Products enhanced/discontinued. Extensive change to printed outputs/end-user screens
Customer/channel interface	Give customers/channels single view of new organisation (e.g. single account statement). Mailshots for key communications.
Management information	Produce meaningful management information, in line with new organisational model
Early integration for key applications	Business priorities – HR system to support staff selection, office/intranet for day-to-day communications, workflow

Table 2: *Sample project elements enabling business integration*

Problems arise over locations as decisions on premises are often finalised late. There is work in ensuring correct address and phone data across all applications. Rebranding/rebadging work can be major if the changes to logos and wording affects the form layout. Providing an integrated view to customers probably depends on lash-up back-end processing initially.

Existing management IS may be fundamentally incompatible in their basic definitions. Human resource systems are needed early to support staff selection and for staffing the integration project itself.

Requirements are always key in projects, but in post merger volatility of unclear authorities, conflicting priorities and fixed deadlines, lean but firm change control is critical.

7.   IT DEPARTMENT – REORGANISATION AND ON-GOING RESPONSIBILITIES

A major activity for IS, aside from supporting business integration, is to merge the IT departments. There are essentially two models (Johnston and Yetton 1996) – use one as the blueprint for the new structure or design a new model. In either case, IS management needs to consider organisation, roles, processes, standards and measurements. Organisational design factors include:

- organisation chart, positions, reporting lines and responsibilities,
- operational processes
- Finance – measurement systems, cost recovery, chargeback
- Authorisation levels, project initiation processes
- Procurement policies
- Standards

Modeling on an existing department may alienate the other, however setting up a new model means many additional activities during the merger period. Moving rapidly to a new model may result in disaffected IT staff just when the firm depends on them most. For staff there is a steep learning curve for new processes and standards. For IS management, clear processes for authorisation and the initiation of work are a priority to allow other projects to proceed.

A key requirement is to continue to support critical projects that cannot be stopped. Projects that cannot be deferred may include e-business initiatives, EMU, legal/statutory conformance, and critical re-engineering projects. But some major projects may be scrapped or deferred and the resources redeployed. The decision for IS management depends on write-off costs, morale impacts, politics and how to utilise redundant skills.

Business integration places additional demands on IS, including system resources to cover extended working hours during integration. There is a need to bolster helpdesk and service management to cope with the high volume and stress-level of users' calls. This is exacerbated by unfamiliarity of users with the new systems. There may be urgent requests as the systems and users bed down. These pressures drive the need for extended systems availability (for training, clearing backlogs) just when IT would like to reduce availability to allow testing, infrastructure moves, data remakes, and conversion runs.

8.   CONCLUSIONS

The cases suggests that there is no single critical issue for IS during a merger. Multiple resource conflicts and constraints add up disproportionately, and there are more dependencies than in any typical IS project, particularly between the applications developers and the service delivery functions. None are insurmountable or complex but are concurrent, dependent, interrelated and compete for resources. This takes place in a turbulent, uncertain environment, with last-minute requirements, external constraints and differing personal objectives. The business integration strategy is the prime driver but also the major constraint on IS. Mapping to the new structure may be extremely complex. There may be application constraints too.

Some of the case firms have a history of mergers, so a stable state may be a moving target. However, as market credibility is wrapped up in mergers, IS management needs to run and evaluate a pilot and build the lessons into the rollout plan. In parallel it needs quick wins to demonstrate progress and maintain morale. The firm structure inherent in legacy systems may be a poor fit to the new organisational design.

Finally, the real business critical systems are not always those documented, so flexibility is paramount. The integration team will discover business-critical applications that run on productivity tools or office systems unknown to the IT department and without support, backup or disaster recovery. However good the planning, such challenges will always emerge.

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