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VOICE OF THE DEAL ECONOMY

Making megabanks

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After more than two decades of consolidation in the financial services industry, the book on post-merger integration in the sector is a thick one. It contains lessons learned about everything from information technology consolidation to brand management to the cultural challenges of getting investment bankers and commercial bankers to work together in harmony. But the most interesting and by far the most important chapter is still to be written.

That would be the chapter on the wave of integration work now getting under way as a series of huge, hastily agreed-to mergers transforms the badly damaged sector. Among the most dramatic deals -- most of them announced on a Monday after a frantic weekend of negotiations -- are **J.P. Morgan Chase & Co.**'s acquisitions of Bear Stearns Cos. and Washington Mutual Inc.; **Bank of America Corp.**'s acquisitions of Countrywide Financial Corp. and **Merrill Lynch & Co.**; **Barclays plc**'s purchase of the investment banking operations of **Lehman Brothers Holdings Inc.** and the acquisition of **Wachovia Corp.**, in whole or in part, by either **Citigroup Inc.** or **Wells Fargo & Co.**, or maybe a combination of the two.

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Apart from some sizable cost-saving targets, the companies involved have yet to release many specifics about their integration plans. But conversations with consultants in the field -- who, needless to say, can expect to be very busy in the coming years -- point to several factors that will make these integrations different from those that preceded them, even as they build upon what came before. They also highlight the inherent uncertainties in trying to combine giant organizations in an industry landscape shifting so dramatically.

The most obvious factor making recent deals different is how they came together so quickly. In quieter times, acquirers can usually make fairly detailed decisions early in the process about such matters as how to combine retail networks, align products, manage brands and deploy personnel. Those details are factored into the price, outlined for shareholders and included in integration plans. But when you buy a distressed company at a greatly reduced price, often with the help of a regulator, the dynamic is very different.

Emergency deals are not priced on estimates of future cash flows, observes David Carney, a principal with **Deloitte Consulting LLP**. Instead, criteria are likely to include educated guesses about opaque financial assets, estimates of the number of professionals coming over and how productive they'll be, and simply the value of the target's real estate. "You look at some of the deals being crafted," says Carney, "and sometimes the real estate property value is 70% to 80% of the deal price."

So while investors appreciate the transactional track records of CEOs such as Jamie Dimon of J.P. Morgan Chase and Ken Lewis of BofA, they still look forward to scrutinizing the details on how these combinations will actually work. How patient they will be while awaiting those details is a matter of opinion.

Work in progress

Buyer	Target	Price ($bill.)	Projected synergies ($bill.)	Integration preview
Bank of America Corp.	**Merrill Lynch & Co.**	**$50.0**	$7.0	Cultural challenges in blending commercial bank/investment bank/brokerage business; layoffs could reach 27,000; cross-selling of products requires employee retraining; ongoing integration of Countrywide could prove distracting
J.P. Morgan Chase & Co.	**Washington Mutual Inc.**, banking assets*	**1.9**	1.5	Technically straightforward; cross-selling of products requires employee retraining; layoffs could be significant, as could uniform branch design/rebranding; Bear, Stearns Co. integration mostly complete
Barclays Capital Inc.	**Lehman Brothers Holding Inc.**, North American I-banking and capital markets businesses	**1.5**	NA	Little geographic overlap in I-banking should ease transition; U.K.-based Barclays' existing U.S. presence should lessen cross-border regulatory issues; new governance structure may be need to oversee Lehman's 10,000 U.S. employees

*Sold by FDIC

Source: Corporate Dealmaker

"All of these organizations have time to get these integrations done the right way, unlike a planned acquisition where the synergies drive the selling of the deal to the shareholders, and you've got timelines to hit these synergies," says Jess Varughese, managing partner of **Milestone**, a financial services strategy consulting firm in New York.

Pressure to establish those timelines is bound to come sooner or later, though. "If the perceived value in anticipated synergies is not captured," predicts Dino Mauricio of **Getzler Henrich & Associates LLC**, "you could see a very quick evaporation of market value." Both BofA and J.P. Morgan have announced sizable synergy goals, he says, but not much detail. "You'll likely see a very impatient market that wants to see those synergies addressed quickly -- not necessarily captured, but defined appropriately and built into the operating plan to produce tangible results."

In normal times, that sounds like a reasonable thing for investors to want. But this is not exactly a normal time to devise an operating plan in the financial services sector. While the old system obviously needs changing, it's still unclear what the new one should look like. The trend seems to be toward a few huge, universal banks. Yet it's one thing to recognize that a big retail deposit base provides a stable platform for brokerage and investment banking activities and quite another to design an organization that combines these businesses in a way that satisfies employees, customers, shareholders and regulators.

"I think the jury is still out on whether all of the product lines of an investment bank and all of the product lines of a commercial bank will actually be allowed to coexist -- either from a market valuation standpoint, i.e., whether shareholders will find that useful and pay for it, and also from a regulatory standpoint," says Michael McKeon, a senior vice president in the financial services group at **Booz & Co.**

For now, these questions loom largest for Lewis at BofA, who, having agreed to buy Merrill in a $50 billion deal, now faces the challenge of melding Merrill's big brokerage and investment banking businesses with BofA's national retail and commercial banking platform, itself the result of dozens of acquisitions. But the same questions apply to any institution that aspires to be one of the surviving giants in this brutal consolidation process. That includes **Goldman, Sachs & Co.** and **Morgan Stanley**, which late last month transformed themselves into bank holding companies. And it also includes Citigroup, which led the way in combining these disparate businesses under one umbrella, but was still struggling to integrate them when the financial earthquake hit.

First things first, though. As of Oct. 7, the most urgent task for Lewis was shoring up BofA's capital position by cutting the dividend in half and issuing $10 billion in stock. Late last month, J.P. Morgan sold $11.5 billion worth of stock to backstop its

WaMu deal.

Then, of course, there's the task of sorting through the assets that J.P. Morgan, BofA and other acquirers are bringing onto their balance sheets. Art Bert, global lead for the corporate strategy practice at **Accenture Ltd.**, and Michael Henry, the firm's North America financial services strategy lead, say there's typically a process of "battlefield triage," wherein the buyer scours the target's portfolio for the most distressed assets, with a view to liquidating them or at least hedging against further damage.

The results of those efforts will likely come to light over the winter. "When the deals were announced, we saw certain proclamations in terms of the size of the write-offs that would be taken in some of these portfolios," says Bert. "It will be interesting to see over the coming months, once due diligence is really done, whether those numbers are adjusted up or down."

In some deals, at least, such urgent tasks may make it harder for top management to deliver the timely decisions about roles and responsibilities every integration playbook says are key to making these big deals work. According to Andy Maguire, who leads the global retail banking practice at **Boston Consulting Group**, the extraordinary market conditions may win decision makers a little understanding. "A good message at a difficult time," he says, "is roughly 'We haven't made any definite decisions. We'll go through a process of working out what the best combination is so we get the best of both.' "

But only a little. Even in difficult times, Maguire says, the goal should be to make the first major round of appointments in the first six to eight weeks after a deal closes. Within four or five months, he reckons, all decisions regarding managerial positions should be made.

In BofA's acquisition of Merrill, a great many decisions await, on everything from key executives to the fates of the two brands. The biggest announcement so far is that Merrill CEO John Thain will stay on to run the global banking, securities and wealth management operations (perhaps putting him in line for the top job later on). That should help the integration. This deal is unlike any BofA has done in the past, one where the bank's standard procedure of requiring the target to do things the BofA way is unlikely to work.

The biggest prize is Merrill's retail brokerage business, which will give the bank a powerful position in wealth management if enough of the brokers -- whom rivals are eagerly recruiting -- can be brought on board. Absorbing the brokerage and investment banking businesses is a delicate process, given the big gaps in compensation and culture between the two organizations. So most observers expect Lewis to move cautiously here.

On the other hand, Lewis has already promised to achieve $7 billion in cost savings. To do that, says Alois Pirker, senior analyst with **Aite Group LLC**, a strategic adviser to financial services firms, he must cut jobs. "There's no way around that," says Pirker, who estimates that up to 27,000 employees will lose their jobs, with cuts likely coming from BofA's own brokerage unit.

Over time, though, getting the real value of the merger on the wealth management front will require cross-selling on a level to which others, notably Citigroup, have aspired, but no company has really achieved. Acccording to Pirker, BofA's banking products must be wrapped into the Merrill organization, whose clients typically have a net worth of $250,000 or more. And Merrill's brokerage services will need to be offered through BofA branches, where current clients usually have a net worth of $250,000 or less.

Designing and implementing the products is the easy part. The biggest integration hurdle, according to Pirker, is training employees throughout the merged organization to cross-sell offerings at different price points and to a range of clients.

"That's where a lot of the strategic initiatives fall down in the end: because the advisers or branch personnel just don't get the products. And if they don't understand the products, they're not going to be comfortable explaining them to clients and they're not going to sell them," says Pirker. "It's one of the biggest problems these firms face. And given the magnitude of the work forces at BofA and Merrill Lynch, to train all of those employees is a massive undertaking."

A less massive but no less formidable undertaking awaits on the wholesale side of the business. Various institutions have been laboring for years to bridge the culture and compensation gap between commercial and investment bankers.

It's not easy.

"A commercial bank is a risk-averse environment," says Piotr Bednarczuk of human resources consultantcy **Hewitt Associates LLC**.

"The focus is to control or minimize the risk to the greatest degree possible. There is much more risk taking in investment banking. If you take these two and have committees discussing investments by the bank, you'll have frustration."

Even when the commercial and I-banking arms are kept separate, as Bednarczuk says is the case with many European universal

banks, there may be a struggle to see which entity dominates.

The gulf isn't merely financial. Hewitt's David Kompare cites the experience of **Deutsche Bank AG** when it bought derivatives powerhouse Bankers Trust in 1998. "When Deutsche Bank acquired Bankers Trust, they put in place some of the most lucrative retention awards that had ever been seen up until that point," says Kompare. "If you look at what happened, a number of the executives with those awards left. There was never any statement as to why, but I think cultural factors did play a role. When you look at the amount of money left on the table, you have to say there was something more at play."

Of course, that was 10 years, two crises and what feels like a lifetime ago. Perhaps current conditions and current deals in progress will yield a model for investment banking that's a better fit for universal banks run by the likes of Dimon and Lewis. Maybe some investment bankers will stay, trading autonomy and bonus money for job security, while others depart for hedge funds and private equity shops.

Maybe regulators will rein in these far-too-big to fail universal banks now being created, and we'll return to the days when bank stocks were more like utility stocks, paying half their earnings out in dividends.

Or maybe not. It's hard to form a view of the future when the present is so chaotic. But for the executives building these institutions -- not to mention regulators, investors and the public -- it's just as important to have one as it is to learn from the past.