Citisoft

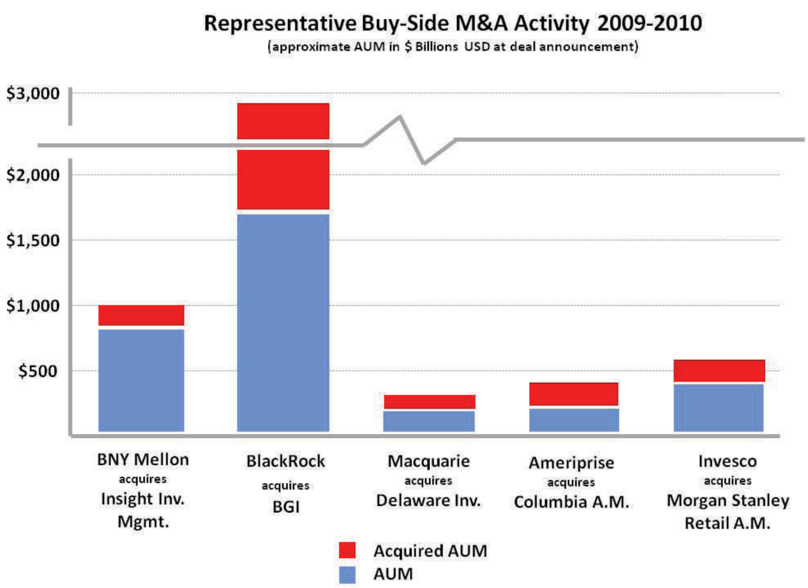
Global Investment Management Consultants

Industry Perspectives

BUY-SIDE MERGER INTEGRATION: NEW CHALLENGES, NEW OPPORTUNITIES

INTRODUCTION

The landscape of the investment management industry changed dramatically in 2009 and that trend is certain to continue now that 2010 is upon us. Diversified financial services organizations have sold their investment management divisions, large firms are combining to form global powerhouses, and small firms have merged to stay competitive. Along with many other goals, mergers and acquisitions are envisioned to broaden investment strategies, enhance distributions capabilities, and gain access to new markets. These visions are certainly are achievable; however creating a stronger, more competitive firm in the long run is a very complex undertaking.



Once a deal is agreed to, market positioning, product rationalization, and human capital decisions are amongst the many events put into motion. It is essential for the combined firm to outline its strategy in these areas and clearly communicate to its clients, the marketplace, and its employees. One of the lesser publicized - yet no less important – events is integrating investment operations and technology. The nature of the transaction generates duplicative applications and job roles across investment functions such as trade order management, portfolio accounting, client reporting and other areas. Establishing a common operational and technical infrastructure is a means to achieving significant cost savings and a key enabler for the two firms to create a successful combined entity. However the integration effort is difficult and filled with hidden challenges.

MODERN INTEGRATION CHALLENGES

Citisoft recognizes that the road to forming the target state infrastructure is filled with unexpected obstacles. Based on our experience, we have identified some old and some new integration challenges that can become persistent long-term drags on realizing cost savings if not addressed early on.

- **Unwinding highly customized applications:** What happens if one of the applications destined for decommission is used for considerably more than its primary function? For example, what if one firm's proprietary portfolio accounting system has been in production for 15+ years is also employed as a primary tool for investment manager decision support and end client reporting? Now a 1:1 system conversion is suddenly a 3:1 (or potentially more!) conversion depending on the proposed end-state platform.
- **Operations Structure:** Identifying and implementing the combined firm's operational structure has a myriad of cultural, contractual, cost, client and other factors that make this integration complex and lengthy. For example, if one operation is internal while the other is outsourced, the structure may be full-service vs. functional vs. hybrid and vary even further across the functions performed. This variance makes an 'apples to apples' cost analysis challenging and introduces many intangibles into the decision such as client (external and front office) service expectations or service provider preference.
- **Partial deals:** Traditionally, most mergers and acquisitions encompassed the entire firm(s) in question. With the evolution of highly diversified financial services firms, we are now seeing more deals for specific asset groups and/or business lines. This presents a series of additional challenges to both sides of the transaction. Firms selling most of their product lines and all of the existing technology and operations must find a new platform for the remaining business line(s) by 'Legal Day One.' On the flip side, purchasing firms have to onboard assets to their current platforms within a compressed time period regardless if it's the long-term solution. Both scenarios may lead to throwaway development, short-term operating models, and staged integrations to the ultimate, strategic solutions.

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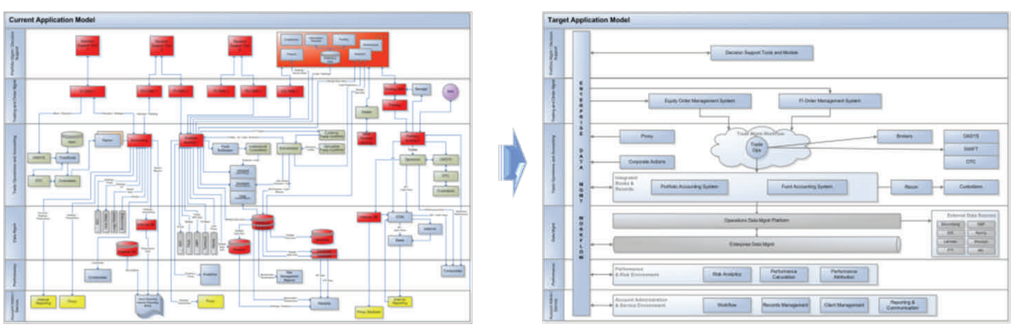
MODERN INTEGRATION CHALLENGES (Con't)

- **Strategic and Tactical Data Decisions:** Determining the new entity's data management strategy and primary data management and storage technology is a critical activity to ensure process and reporting consistency, uninterrupted risk monitoring, etc. But in addition to making decisions on key application components, another critical activity that must be performed is the identification of the 'one-off' databases, excel 'mini-applications' and stores, and other user-maintained technology that support the day-to-day. More importantly, it's essential to understand what core application deficiencies these programs are addressing and how broad the user base is throughout the firm.

ACCELERATING INTEGRATION

Citisoft has a track record of helping investment management firms accelerate their operations and technology integration and recognizing the cost efficiencies and competitive advantages envisioned in a deal. We believe that initiating a few key activities will move the integration effort quickly off the starting line.

<u>Define the Future State Application Platform:</u> The deal will leave the combined firm with many duplicate applications, disparate data stores, and 'local' systems that are not a scalable future state model. Many of these systems will have development efforts in progress or planned. Determining the target state quickly and rationalizing the applications will facilitate proper allocation of development funds and associated resources.



<u>Phase the Integration:</u> Application rationalization and the subsequent functional enhancements, data migration, and decommissioning are complex and lengthy initiatives. They should be phased accordingly to support deal terms, vendor contract terms, business line priorities, and resource levels.

<u>Define the Operations Structure:</u> In parallel with the Future State Application definition, the firm should define the Target Operations structure as early as possible. Depending on the path chosen, this decision will spawn a series of major activities including: organizational/ personnel restructuring, service provider migration (if outsourced), business process redesign, and the associated data conversions.

Starting Points:

So you find out that your firm is acquiring another asset manager or are being acquired; what next? Here are a list of questions to consider asking to better prepare for the critical integration work to follow:

- *How are the firm's operations structured? By function, by product line, hybrid model?*
- *What operational functions are performed in-house vs. outsourced? If outsourced, how many service providers are engaged and what are the segregation of functions?*
- *Do you have the experienced resources that can think strategically and simultaneously execute?*
- *What percentage of the application suite is custom built and how well is this documented?*
- *Is there a central data warehouse or is data maintained in multiple local data stores?*
- *How scalable are the current processes and systems both from an operational automation and system capacity perspective?*

For more information on this topic, please contact us at: +1 617 428 9580 or by email at marketing@citisoft.com