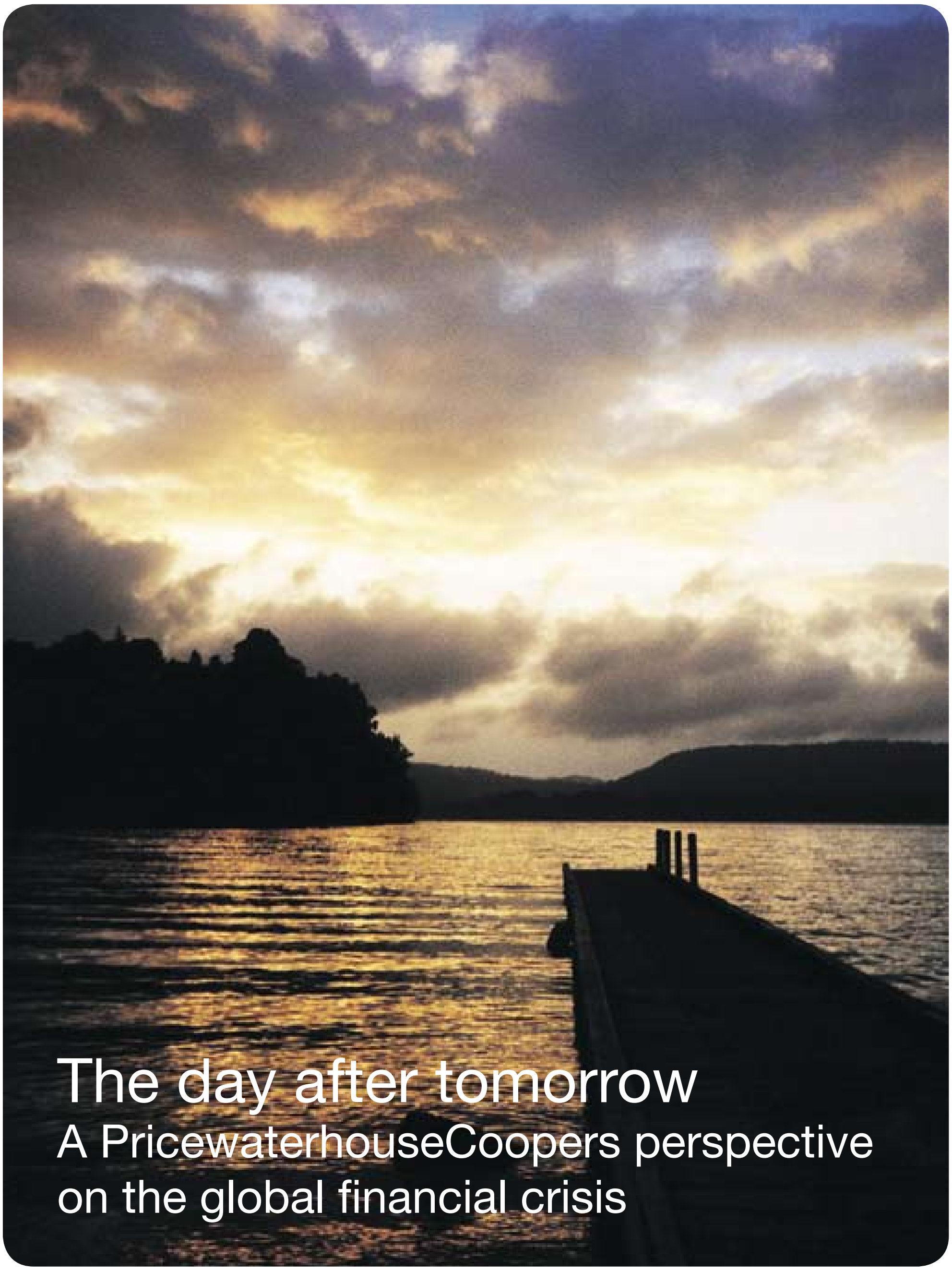
Financial Services Indonesia

no. 2/09

Financial Services NewsFlash*

In this issue

- The day after tomorrow A PricewaterhouseCoopers perspective on the global financial crisis
- Managing effectively in a downturn, turning challenges into opportunities
- Insurance Banana Skins 2009 Identifying the risks insurers face
- Outsourcing of IT processes
- Extracting value in post merger integration – time to look again?
- Boosting profitability through change



The day after tomorrow

A PricewaterhouseCoopers perspective on the global financial crisis

The global financial landscape is going through unprecedented change. Emerging themes and new business models will evolve as the fallout from the credit crisis continues and the financial services providers grapple with a new environment. The effects of this crisis are impacting financial institutions around the world, including Indonesia.

A recent "point of view" issued by the firm analyses key themes that are likely to permanently reshape the financial services sector at the global and local level.

A distinguishing feature of the new landscape is an accelerated shift of economic power towards the East; a simpler, more transparent form of banking based on a more classic banking model; Governments "inside the tent", raising significant conflicts of interest; a stricter governance structure based on national and international regulation; and the need for sustainable business models that move financial institutions from survival to longer term strategies.

Commenting on the new financial services world, Stuart Scoular, Technical Advisor and the Indonesian Financial Services Leader, believes "We live in unprecedented times. Not only have we seen the global landscape change around us, the existing banking environment is likely to permanently change.
For Indonesia, this may lead to increased regulation, a return to 'basic banking models' and a possible contraction for some international banks in this market".

The credit markets were the first to be engulfed, but the contagion has reached all asset classes that were reliant on cheap money and high leverage, bringing a demise of the US investment banking model and sending some countries into bankruptcy. The full extent of how global financial markets are interwoven has been revealed.

Despite being in relatively good shape following the Asian Crisis, Indonesia has been affected. We have seen significant tightening of liquidity, increasing credit and derivative losses, decreasing commodity prices and slowing economic growth.

Cliff Rees, Director, and the Financial Services Advisory Leader, believes "While Asia and Indonesia are well positioned relative to other countries; the economic fallout is likely to be painful. Certain sectors in the economy are showing signs of weakness which will impact the banking sector".

Unlike in the wake of earlier crises in the post-war period, the world and its financial markets will not resume their former pattern. The balance of economic power will shift towards the East as part of a trend towards a less US-centric world economy.

Emerging market countries, like Indonesia, will increasingly influence patterns of trade and investment to reflect their own natural resource requirements and the banking system will follow these flows. As such, relative to the world economies, Indonesia will represent a relatively larger and important part of the global economy.

The nature of the banking system will change. Unsustainable, overleveraged structures will be replaced with simpler and more transparent forms of banking, and some activities may be subject to limitations in a new model that represents a renaissance of 'classic banking'.

The emergence of this model will be driven by increased regulatory pressure and the need for banks to adapt their businesses to new capital constraints.
A massive de-leveraging process is under way on the part of both financial institutions and debt-addicted Western consumers. In this more capital-constrained world, the banking system will be smaller, more transparent and subject to stricter regulation.

Margie Margaret, Partner and the Tax Financial Services Leader, believes "For Indonesia, the focus of global organizations in de-leveraging and de-risking their balance sheets may lead to a curtailment in investment and growth plans and for some international institutions a withdrawal of certain activities. This, however, does create an opportunity for those organizations with access to capital to invest in this market".

The contraction in capital, credit and liquidity has created a 'monetary vacuum' at the centre of the banking system. Financial institutions and governments have attempted to fill that vacuum with fresh capital and sovereign wealth fund investors. With governments now 'inside the tent', providing liquidity and financial guarantees and in some cases holding major or controlling stakes in banks, the long-term implications of this crisis management are profound.

Hoping to ensure that a crisis on this scale is never repeated, governments and regulators will pursue 'zero risk' regulation. Their influence in the financial system will be far reaching, long-term and will raise significant conflicts of interest.

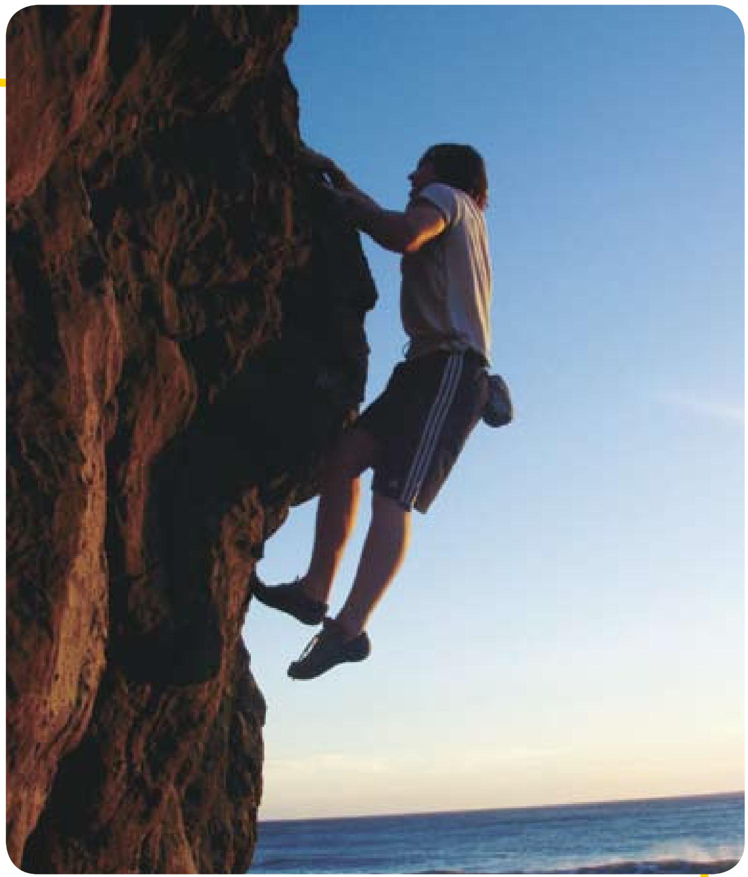
Lucy Suhenda, Partner and Financial Services Assurance Leader, believes "Significant deficiencies have been identified in the existing regulatory regime. With profound government influence, the regulation of banks will materially change leading to the tighter scrutiny of institutions, including in Indonesia".

The winners from this crisis will be those that do what is required for survival and also adapt to the realities of a new world.

Stuart Scoular said, "While it is easy to lose sight of longer-term trends during a crisis, the underlying forces shaping the future have not changed. These include aging populations in developed markets; the faster growth in E7 economies relative to the G7; and the continuation of technological advances".

To remain competitive, financial institutions must build these powerful long-term trends into their sustainable business strategies, and they must do it sooner rather than later. ■

Managing effectively in a downturn, turning challenges into opportunities



Both the USA and Europe are facing a serious downturn if not a recession caused by the Credit Crisis. These are significant markets for Indonesian exports. The downturns in global Commodity Prices and Markets also have serious consequences to the Indonesian Economy. The Indonesian Government has already taken a number of actions to increase liquidity in the Indonesia banking sector and to help support the serious fall in the Indonesian Stock Markets. The Government has already downgraded its GDP growth.

There is a possibility that there will be a serious downturn in Indonesia caused by Global problems. Indonesian businesses and their executives therefore face considerable challenges – and managing in a downturn. Although Indonesian businesses only recently came out of the Asian Crisis in 2002 – 2003, these experiences are still relevant; however there is a need to remind everyone of the challenges that may arise.

Effective managers – whether or not they have the benefit of the experience of a previous recession – must consider the effects of the downturn and what it means for their business and its survival. Then they should address the key questions – what do we need to do differently, what do we need to do better? Often, the secret of survival will be getting the simple things right rather than embarking on wholesale radical change in every aspect of the operation. Many practical steps can be taken to minimise the effect of the downturn and position the business to emerge strongly when economic conditions improve.

1. Understand the true impact of the downturn on your business

When assessing how the downturn will impact your business you should pose these questions to your self and your colleagues:

- How will our customers behave – will they trade down to the cheapest model in the range, purchase the same product less often, or seek a substitute product or service?
- How will our competitors react – will they work with customers to re- engineer their products, seek to maintain volumes by cutting prices, or seek alliances to reduce market competition?
- What do we need to do well to minimise the impact of the downturn on us – play to the strength of our existing customer base rather than seek to expand, focus on those customers most likely to thrive in difficult times, suspend product development in favour of supporting existing brands, revisit our pricing policies?

You need to assess how different segments of your customer base will behave in the downturn, how price sensitive they are and how loyal they are to your product or service. You should also assess how strong your competitors are – will they see the slowdown as a threat or an opportunity? You then need to adapt your strategy to the changed conditions and assess whether the new strategy has implications in other areas such as, for example, operations, risk management or liquidity needs. Given the volatility which exists in current markets it makes sense to subject your assessment of the impact of the downturn on your business to stress testing and scenario planning. Only when you have considered the potential range of future outcomes can you determine the optimum course of action to take. When conditions are difficult, the most successful businesses are the ones that react quickest – those that take the tough decisions early and lead rather than follow. Once you have defined your new strategy, share it with management and drive it. Make your key people accountable for targets which are consistent with your revised strategy.

2. Identify unprofitable products and customers

When resources are limited it is critically important to be aware of the profitability of individual customers and products. Profitable customers and products need and deserve investment – not least because they will be at risk of loss to competitors – whilst unprofitable customers and products require detailed analysis to determine whether or not the position can be rectified. It makes no sense to have scarce resources, in the form of financial investment or management time, tied up in delivering products or services at nil or negligible profit unless a rapid improvement can be achieved. Establishing product, customer and segment profitability requires a thorough analysis to ensure that all direct and indirect costs are considered. When this is done, corrective action for non-performing products or customers can include price increases, cost reduction, amendments to terms of trade and in some cases removal from your portfolio.

Once you have identified your profitable products and customers you should invest the time and resources to stay close to them. You need to understand how they are impacted by the downturn and convince them of the benefits of your product or service.

3. Cost reduction

Cost control is a necessary obsession for any business. In good times however, it is frequently subordinated to the imperatives of growth and development. In a downturn, cost control and cost reduction must be a prime focus of management who should start with a blank sheet.

Sustainable cost reduction involves moving from your current cost base to a lower cost model. This will involve a fundamental reappraisal of the business model in all its aspects, and will require sustained management commitment over a considerable time.

In the short term, the quickest route to cost reduction is to target discretionary expenditure – segregate the essential from the desirable and limit outgoings accordingly.

In the medium term, cost reduction must come from examination of the present cost base and an assessment of the value derived from each significant cost category. This review should consider the level of cost in all areas of the business and then seek to identify where savings are possible. Take a hard look at procurement, at inefficient work practices, and at waste.

A key action at this stage is to increase cost consciousness throughout the business, get people involved and reward measurable contributions.

In the longer term, cost reduction will involve driving down the business break-even point to as low a level as possible – making costs variable rather than fixed in order to minimise vulnerability to a downturn. This will involve examining just about everything – the market the business should be targeting, the product or service offering, the opportunities for outsourcing, the desirability of centralising or outsourcing support functions, reworking the management information system, and redesigning remuneration policies. This kind of change cannot be achieved in weeks or months, but the threats presented by the downturn will persuade all stakeholders of the need for regular reinvention.

4. Effective working capital management

When 'cash is king' everyone in the business should be focused on minimising investment in working capital. Effective working capital management will limit reliance on lenders, contain financing costs, and reduce the risk of loss through bad debts. Individual strategies to deal with levels of debtors, and creditors are required, for example:

- Cash collection should be proactively managed – perhaps by deploying additional resources to the credit control function, or offering customer incentives such as early payment discounts. Ensure that you process invoices on time and stay close to who pays you.
- Enhance collection efforts and be prepared to restructure loans in a practice manner.
- Suppliers should be paid in accordance with agreed credit terms and not before due, unless attractive settlement discounts are on offer.

Effective working capital management in a downturn will require close contact with customers and suppliers, ongoing review of your liquidity requirements, and, potentially, streamlining product ranges.

5. Effective performance management and forecasting

The function of management information systems can no longer be limited to measurement of past financial performance. Focused reporting and effective forecasting are critical to both effective planning and day-to-day management, particularly in a downturn. Timely, benchmarked, feedback is essential for sound decision making. In the short term, a focus on a limited number of key performance indicators is required. These measures should be transparent, unambiguous and easily understood. The KPIs, which should have a focus on liquidity, should be formally communicated and managers should be encouraged through, for example, incentivisation, to deliver on them.

The medium term perspective requires a strong financial forecasting capability. Rolling forecasts, which are produced as a matter of routine directly from the management information system, will provide management with the necessary flexibility plan for likely developments in the marketplace on a timely basis.

6. An experienced and well resourced finance team

A downturn produces new challenges for all parts of an organisation, but the finance function will come under particular pressure to meet increasing demands for information to support initiatives throughout the business. The resource needs in this area – in terms of people, experience and IT support must be a priority for senior management. Short term needs can be met by contractors or secondees while the longer term requirements of the business are assessed.

7. Strategic M&A activity

Lessons learnt from previous downturns have shown that merger and acquisition opportunities will present themselves in most industries. The key to availing of these opportunities, which tend to be more favourably priced than in a booming economy, is having the financial and operating flexibility to move quickly. There are particular skillsets required in acquiring distressed businesses and experience shows that if deals are effectively managed in a downturn there is the potential to generate above average returns once trading conditions return to normal.

8. Careful tax planning

It is important not to lose sight of the importance of careful tax planning while dealing with the new management challenges presented by the downturn. While still ensuring that your organisation remains fully tax compliant, it should be possible to improve your cash flow position by managing monthly corporate tax installment and/or reducing tax payments to the Tax Office in accordance with the new tax and law regulations. Opportunities here would include making maximum use of losses in calculating Preliminary Tax Payments and ensuring that all available deductions are being claimed.

At a more strategic level, falling asset values can also be taken advantage of for crystallising losses and tax effective succession planning.

From a human resource perspective tax efficient remuneration strategies is more important than ever; likewise, the tax implications of any workforce reduction which proves necessary – for both the business and the individuals concerned – should be closely examined.

9. Communicate with stakeholders

Managing the stakeholders in a business is critical, especially in difficult times. The key to effective management of all relationships (whether with shareholders, employees, customers, the tax authorities or providers of finance) is timely and honest communication. Withholding information or springing surprises is likely to unnerve people and erode their confidence in your ability to manage the business.

It is important that you keep all stakeholders informed about the threats and opportunities that a downturn brings to the business and about the actions that you are taking to manage them. While the required communication can be very time-consuming, particularly when there are many other challenges to be addressed, it is a vitally important investment.

10. Manage key talent effectively

The 2008 PwC Global CEO survey highlighted that concerns over people and talent far outweighed fears of recession. Engage with your people and be open with them. Ensure you motivate and develop high-performers. Watch for pressure points but also be aware that key talent may be more readily available for recruitment than was the case in the boom times. It is also likely that recruitment costs and packages will be more competitive in a downturn and this can present opportunities for your business.

Challenge as opportunity

In a downturn, numerous difficulties present themselves – all important, all urgent. A natural response may be to “batten down the hatches” and focus solely on today’s problems. Prudent management is of course necessary, but it is important also to recognise the opportunities presented – to challenge old ways of doing things, to take advantage of weaker competitors, to plan for the changed marketplace that will emerge. Effective management will help ensure your business is best placed to come through the bad times re-energised and fit for the future.

Thriving in a downturn requires greater diligence and skill than during more favourable economic times.

However, the rewards can be greater as businesses that adapt quickly with the right strategies can not only grow, but position themselves strongly for the inevitable upturn that will emerge.

Addressing the points above will help ensure your business is best placed to come through the bad times re-energised and fit for the future. ■

Insurance Banana Skins 2009
Identifying the risks insurers face

Insurance Banana Skins 2009 survey is conducted by the Centre for the Study of Financial Innovation and sponsored by PricewaterhouseCoopers.

Insurance Banana Skins surveys the risks facing the insurance industry at a time of great stress in the financial sector, and identifies those that are seen as most pressing by insurance practitioners and close observers of the insurance scene.

With over 400 responses from 39 countries, including Indonesia with 10 responses from 10 insurance companies, the survey shows financial market concerns, including investment performance, equity markets and capital management, topping the ranking of risks facing the industry in many parts of the world. This is in sharp contrast to the previous survey in 2007 when too much regulation and natural catastrophes were top of mind, and market risks barely featured in the top ten.

The industry faces key challenges as it looks to operate in a low investment return and low interest rate environment. Maintaining profitability and properly managing risk against the backdrop will test even the most experienced management teams.

Do insurers feel prepared?

There might be some debate about how ‘unjust’ this is, but it is very clear that the insurers are living in a new environment – an environment created by the banking crisis. In particular, it is an environment characterised by:

- low or negative investment returns;
- an acute shortage of capital;
- a dreadful macro-economic outlook;
- a backlash against financial complexity;
- increasing political involvement, even in mature markets; and
- the inevitability of much tougher regulation at all levels.

Obviously, all of these affect the individual pillars of the insurance industry in different ways and to different degrees. For the life companies, for instance,

investment returns are the major threat. As one respondent put it, with some understatement, 'there is a real danger of a loss of faith in annuities'. For the non-life sector, capacity and pricing are the big issues, along with the problems that tend to come with a macro-economic slowdown – notably a surge in claims and an increase in fraud. Plus, the industry’s problems are bound to be exacerbated by the regulatory crackdown. For the reinsurers, sustaining capacity looks like the big problem, along with management of the pricing cycle.

And then, of course, there is reputational risk; insurance is at least as vulnerable here as banking.

One could go on. But what makes everything worse this year is a pervasive sense that the insurance industry isn’t as well prepared as it should be.
The survey reveals a dramatic fall in insurers feeling well-prepared to address the risks identified a drop from 21% down to 4%. But, there is a reassuring increase in the risk sensitivity level reflecting a shift in interest, with risk moving up the board agenda.

The Summary

The top three risks identified by respondents to the survey are all connected with the fall-out from the credit crunch, and its impact on the strength and profitability of the insurance industry.

The ability of insurance companies to get through the crisis depends above all on their investment performance (placed No 1), i.e. achieving sufficient returns to protect capital, remain profitable and meet commitments to customers. Key here are the equity markets (No 2) on which the industry will depend heavily for income if, as expected, the crisis produces a fall-off in insurance business and a surge in claims.
An extended period of extra low interest rates (No 11) would also hurt income and reduce the appeal of savings products.

The resulting squeeze on profitability could affect the industry's solvency, making capital availability (No 3) a key consideration in the period ahead. The scale of financial market disruption will depend on macro-economic trends (No 4) about which the majority of respondents to the survey were gloomy, particularly those in North America. The risk of Too much regulation (No 5) has fallen from the top position it occupied in the last survey. But it has not disappeared, only been overtaken by more urgent issues. There is now widespread concern that the crisis will trigger a regulatory crackdown on the financial sector which will put pressure on the insurance industry.

The next set of risks is linked to the industry's ability to manage its way through the crisis and avoid unnecessary losses. Concern about the strength of the industry's risk management techniques (No 6) has risen sharply in the wake of the crisis at AIG and revelations about insurance companies' exposure to complex instruments (No 8), specially those in the credit insurance market. The security of reinsurance arrangements (No 7) is a fast-growing concern with worries about the capacity of the reinsurance sector to meet a surge in claims on risks that have been laid off by primary insurers.

Profitability on the non-life side of the industry will depend heavily on the pricing cycle (No 12). Insurers are hoping that a capacity shake-out will enable them to push up rates, but the Contrary view holds hat insurance business will fall away as clients seek to cut costs.

A growing concern is potential damage to the insurance industry's reputation (No15) caused by insurers' attempts to push up premiums and take a tougher line on insurance claims, as well as disappointing returns on savings products. The industry expects to see an increase in fraud (No 23), a common reaction to hard times. Corporate governance risks (No 17) are also expected to grow as companies come under greater pressure to deliver results.

The survey showed a striking fall in concern about environmental issues. Natural catastrophes fell from No 2 last time to No 22, possibly because of fewer major recent events. Climate change also dropped sharply, from No 4 to No 28, reflecting a sense of declining urgency about the issue. Pollution risks eased noticeably, from No 21 to No 34. Concerns about structural change to the insurance industry were also less prominent. The threat of new competitors fell from No 10 to No 32 because respondents felt the insurance market had become less attractive. Similarly, the prospect of mergers remained low at No 31.

The survey showed a striking similarity between the top level concerns of the life, non-life and reinsurance sectors: all of them focused on The life side homed in on the risks to the savings business and the challenges of the interface with customers: retail sales practices and distribution. The non-life side was concerned with capacity, pricing and claims management. Observers of the industry focused on the strength of the insurance industry's solvency, on risk management and reputation.

There was also a strong similarity between the responses from North America, Europe and Asia, the main regions represented in the survey. The impact of financial turmoil and poor business conditions dominated all three. A common concern was the prospect of a regulatory crackdown at a time when the industry is already feeling the effects of the credit crisis. The possibility of insurance company failures resulting from the crisis was widely mentioned, particularly in emerging markets where the strength and management capability of the industry is still evolving.

Respondents were asked how well prepared the insurance industry was to handle the risks they had identified. The results were more negative than in the last survey. Only four per cent said "well", down from 21 per cent. Eleven per cent said "poorly", up from three per cent. The remainder gave a "mixed" reply.
Overall, the responses to the survey showed that the level of risk sensitivity in the insurance industry has risen since the last survey in 2007. The Banana Skins Index shows the average score given to the top risk in the two surveys, and the average score of all the risks. Both are up. ■

If you'd like to request for softcopy of this report, please contact Maria Purwaningsih (Marcomm) or email to: maria.purwaningsih@id.pwc.com

Outsourcing of IT processes

Should you invest in functions that don't provide a strategic advantage? Or should you invest in functions that can be obtained elsewhere for far cheaper prices? Organisations have long outsourced such functions as cafeteria service, car fleet management and building security. But what about sensitive activities like information technology? "Approached carefully, even business-critical functions can be successfully outsourced," according to Gartner Dataquest.

This article describes outsourcing of the IT function from a practical point of view, identifying the pros and cons, thus helping you to decide whether or not IT outsourcing would be appropriate for your specific circumstances.

Outsourcing – what is it?

Outsourcing is subcontracting a process to another party. It involves the transfer of an entire business function to an external service provider. Business segments typically outsourced include information technology, human resources, real estate management, and accounting. The main driver is often the requirement of the outsourcing company to focus on its core business. However, occasionally core business is outsourced as well! You would be surprised how many authors outsource their writing activities (there is even a word for it: "ghost writing").

Outsourcing and off-shoring

The terms outsourcing and off-shoring are often used interchangeably. However, there are important technical differences. Outsourcing involves contracting a supplier, which may or may not involve some degree of off-shoring. Off-shoring is the transfer of an organisational function to another country, regardless of whether the work is outsourced or stays within the same corporation/company. With increasing globalisation, the distinction between outsourcing and off-shoring will become less clear over time.
This is evident in the increasing presence of, for example, Indian outsourcing companies in the US and in Europe.

Decision

The decision to outsource is made at a strategic level. The process begins with the company identifying what is to be outsourced and building a business case to justify the decision. In the case of IT outsourcing, a business case can be driven by:

- The desire to focus on core operations only, leaving non-core processes to specialists.
- Cost reduction (particularly in the case of labour-intensive IT processes, such as bulk input of data).
- Synergy, where specialised third party IT suppliers can be found for company-specific or branch-specific processes.
- Business continuity planning, in the case that a third party can provide excellent business continuity facilities.

Business cases need to take into account matters such as laws and regulation, and "political matters". Laws and regulations may assign strict conditions to outsourcing, or in some cases even make outsourcing (particularly off-shoring) virtually impossible. Companies can be faced with political pressure, particularly against off-shoring, in jurisdictions with a strong protection of the domestic labour market.

Tasks and responsibilities

Mutual tasks and responsibilities need to be contractually arranged. Usually, a service level agreement (SLA) is used. Key elements of an SLA are:

- Detailed description of the IT services to be provided.

- Metrics to measure delivery of these services, such as reliability rates, problem resolution times, error rates, etc.
- Responsibility of the service acquirer, such as delivery formats of raw data, required output controls, etc.
- Fees, billing and payment arrangements.
- Key contact details.
- Escalation procedures.
- Farce majeure.
- Conflict resolution and jurisdiction applicable in case of any legal matters.

SAS70

When outsourcing IT processes, an independent auditor is often assigned to issue a periodic opinion on the reliability and continuity of the IT processes within the organisation of the service provider. The auditor reports to the management of the service provider, and this report can further be distributed to the outsourcing company. The auditor performs an audit according to the American Statement of Auditing Standard 70, which describes the responsibilities and reporting requirements for outsourced services. A report with a positive opinion will provide reasonable assurance to the outsourcing company that the specified processes within the organisation of the service provider are operating effectively.

Outsourcing, related to BI regulations

Bank Indonesia (BI) covers IT risk management for Indonesian banks in regulation 9/15/BPI/2007. This regulation contains a number of clauses regarding the outsourcing of IT services. The bottom line is that the use of a third party IT service provider does not release the bank from any responsibility related to IT risk management. A solid business case needs to be in place to justify IT outsourcing. An SLA needs to be in place, specifying agreed service levels, and the bank's supervisory role on IT processing, even when it is performed by a third party.
A particular clause in the contract with the IT service provider needs to arrange access for audit purposes by an external auditor (a SAS70 report would cover this), and access on request by Bank Indonesia. This last clause is often not yet included in existing contracts. ■

Extracting value in post merger integration – time to look again?

The impact of the liquidity freeze, the dramatic restructuring of the conduits of that liquidity, the volatility of currency, debt and equity markets all add up to an extraordinary environment where deals have become harder to deliver. With organic growth also facing tougher economic conditions, there are few other options available to companies at the moment. Extracting more value from acquisitions made in the past, when credit was cheap, may be a way for CEOs to satisfy the demand for continued growth.

Post – crisis competition

In the benign business conditions that prevailed until recently, companies had ready access to funding, whether through equity markets or the availability of cheap credit. As a result, it was relatively easy for CEOs to deliver a high-level growth story by becoming serial acquirers, and this was reflected in the high volume of deal activity over the past five years. Even in 2008 where the overall numbers of deals have declined, Asia bucked the trend with a 24% increase in the first six months.

The rude awakening brought about by the credit, and the dramatic restructuring in the primary conduit of liquidity, the global banking sector, has made this type of growth much harder to accomplish. Meanwhile, tightening economic conditions and rising commodity prices will make it harder to achieve organic growth in revenues and increasing competition will continue to put pressure on margins. With very little slack in terms of costs and sourcing, CEOs seem to have few options available with which to answer the pressing demands of shareholders and analysts.

As growth slows, the difference between the acquired business, which are "market leading", and those in the middle of the pack becomes clearer.
But what about all those deals? According to the latest studies, over 60% of mergers destroy value and many more apparently successful deals have still to achieve their full potential. In many cases, it takes years for acquisitions to be fully integrated.

Revisiting unfinished business

The current economic climate and a possibly quieter deal environment offer an ideal opportunity to revisit the "unfinished business" of past mergers and acquisitions.

There are potentially many reasons for a failure to integrate – some may have been valid at the time; others may no longer apply. The acquirer may simply have wanted to retain the option to easily divest an acquisition that subsequently did not fit. Restriction on cross-border entities, now relaxed, may have prevented geographical integration. Or there may have been a wish to preserve brand entities, or high performing business units whose luster has now dimmed

In Asia, growth opportunities have been such that, in many cases, the need to respond quickly to markets has required a series of very fast acquisitions. As buyers moved on from the bought entity to another deal, they have neglected the integration or transformation quick wins.

Often it's been a case of inertia kicking in after the initial motives for the deal have been satisfied. Incompatible systems and processes, or political and cultural differences have led to the trickier areas of integration being postponed indefinitely.

This is partly due to the dynamics of transactions. Serial acquirers tend to focus on emphasizing the savings from synergies over the potential benefits of transformation. They will often commit to fairly conservative synergy targets, and then overachieve on them to realize an immediate premium on share price. Then it is on to the next target, leaving behind a new set of organization silos and uncaptured value.

This may also be due to the limited internal capabilities of organizations with respect to the integration process. In Asia in particular, where non-organic growth and sector consolidation are still relatively new concepts, there is a shortage of skills and talent to drive longer term synergies.This very lack of integration can make it difficult for internal organizational change programmes to achieve, or even spot, the potential benefits of further integration. Problems in a call centre may relate to system issues that are outside that team's remit. Attempts by the sales team to cross-sell may be stymied by a lack of integration at the finance level. It is therefore necessary to revisit past integrations from the highest possible level, with the same level of discipline and expertise as would be applied to a merger. There should be a re-appraisal of what is and is not core to the business.

Time for a tactical revision

Un-integrated, non core areas could be disposed of, but companies can also apply something of the tactics of private equity here: existing business units could potentially be combined or repackaged to make an attractive stand-alone equity.

Looking at integration from this high a level could reveal opportunities that were missed in the initial transaction, possibly due to a lack of data, at the time of the strategic planning process. There may still be legacy systems or duplicate infrastructure to be cleared away. Or there may be departments that can together make a business case for investment that would not have held water in isolation.

Re-priming the change agenda

But the real benefits will accrue to those companies that are now prepared to integrate at a more fundamental level, to change their business model and look for opportunities that are not incremental, but transformational.

This is never going to be an easy task: the beauty of a transaction is that it galvanizes an organization; everyone is on board and, if fearful, at least prepared for change.

After the quick wins of the immediate post-deal period, the benefits of transformation may seem distant and abstract. The CEO needs to develop a compelling change agenda – for example, around the customer proposition – to reignite enthusiasm, and continue to provide sponsorship from the top.

Success rests as much on the senior management who must apply the same level of rigour and resource in the post merger integration phases they do in the initial negotiation and due diligence period. The willingness to move quickly, cut across internal boundaries and execute at speed will be critical.

Internally, the organization will see a revival of the dynamism that previously came from growth. Externally, the market will see a company making significant forward progress in an environment that seemingly offered little room for maneuver. ■

Boosting profitability through change

In the midst of the current market turmoil, banks are squeezed by slowing economic growth and increasing customers' expectation. One of the areas in which banks can improve profitability and enhance customer experience is in the area of lending.

Several ways can be done by banks such as consolidating their middle and back office processes, simplify and standardizing credit processes, leveraging sophisticated sales management tools or moving towards straight-through processes, and enhance customer experience by structuring customer experience across all channels.

An important element of this effort is try to drive efficiency across the organization and to increase the proportion of time spent by relationship managers on value-adding sales. Banks must exploit opportunities to leverage best practices in customer segmentation and business operating model design.

One of the solutions is to further enhance the segmentation of customers according to the profitability and complexities of customers' needs. Banks should understand the true customer profitability to avoid "over-servicing" a low-value customer. In addition to this, banks should avoid customizing credit products regardless of size and applying the same credit and risk assessment processes across all segments. In addition to this, the relationship managers are involved in so many aspect of the loan deal that they spend less time on their core function – sales and relationship management activities.

The appropriate approach which should be further implemented by banks is to segment the loan products into profitability, complexities of customers' needs, and customer preferences. By pinpointing the intersection of customer needs and profitability, banks can define a targeted value proposition and an appropriate sales and service business model for each segment.

A business model that leverages segment-specific relationship coverage and processes can translate into significant revenue and efficiency gains.

Code of conduct The way we do business*

Putting our values in action

Excellence

Delivering what we promise and adding value beyond what is expected.

We achieve excellence through **innovation, learning and agility.**

Teamwork

The best solutions come from working together with colleagues and clients.

Effective teamwork requires **relationships, respects and sharing.**

Leadership

Leading with clients, leading with people and thought leadership.

Leadership demands **courage, vision and integrity.**

Your PricewaterhouseCoopers Indonesia contacts

Stuart Scoular
+62 21 528 91213
stuart.a.scoular@id.pwc.com

Cliff Rees
+62 21 528 90550
cliff.rees@id.pwc.com

Michael Goenawan
+62 21 528 90340
michael.goenawan@id.pwc.com

Andry Atmadja
+62 21 528 90635
andry.atmadja@id.pwc.com

Lucy Suhenda
+62 21 528 91060
lucy.suhenda@id.pwc.com

Jim McMillan
+62 21 528 90861
jim.f.mcmillan@id.pwc.com

Margie Margaret
+62 21 528 90862
margie.margaret@id.pwc.com

Cornelis P Poelman
+62 21 528 90683
cornelis.p.poelman@id.pwc.com

For further information on how PricewaterhouseCoopers Indonesia can assist you, please contact one of the following specialists based in our Jakarta office:

PricewaterhouseCoopers Indonesia
Jl. H.R. Rasuna Said Kav. X-7 No.6
Jakarta 12940 - Indonesia
Telp: +62 21 5212901
Fax: +62 21 5290 5555/52905050

Visit our website at

www.pwc.com/id