Default Remodeling; an explanation of the post merger aftermath

Session: **Grounded Theory Methodology**

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This paper is the first updated explanation of the default remodeling concept, which was first published seven years ago [Lowe(1998)].

An explanation of default remodeling

When two corporate entities merge it is a time of great trauma. Prior to the merger both parties knew who they were and had a very clear notion of their corporate values and identity. Once they are fused together into a new single entity one of the entities gains immediate ascendancy and becomes very dominant. The descendent entity immediately loses power and influence and becomes totally subservient to the ascendant entity. The concept has been named "default remodeling" because the ascendant party, in the midst of the merger trauma, automatically reverts to its own core values and identity with renewed vigor. It instinctively enforces what it knows and understands in these times of uncertainties. The concept of "default remodeling" emerged after a nine-month study of a bank merger as it was happening in Europe. It was interesting to note that this process happened immediately after the merger was finalized. It is well known and expected that following any merger employees will "downsized". However when the ascendant party default remodels groups other innocent victims also are directly affected. It was found that default remodeling had a ricochet effect on several groups of people who were not even employed by either of the merging entities. These included customers and suppliers. In the data collected by this research both banks were of very similar size and stability and had been fierce competitors in the same domestic market for several decades. Bank A was very conservative and minimized lending risks. Bank B aggressively lent funds to maximize profitability. After the merger it was Bank A that emerged as ascendant. The impact on Bank B's customers was devastating. Bank A, post merger, immediately imposed its own notion of risk on all of Bank Bs customers. This meant that all of Bank Bs overdrafts were re-assessed and many were called in with 24 hours of the merger. The same happened to medium and long-term loans and all loan projects still in negotiation were either cancelled or reassessed. The suppliers to Bank B were in large part directly affected by the default remodeling process imposed by Bank A. Most of the contracts of these suppliers were prematurely terminated following the merger.

The default remodeling process flies in the face of the conventional wisdom that is still taught in most academic business schools about mergers. Mergers are taught to be a device whose sole purpose is to create corporate synergy. The impact on "innocent" parties are either played down or never mentioned at all. If all the costs of default remodeling were calculated then the claims of the market efficiency of mergers would also be brought into question.

The research revealed three simultaneous ways in which the newly merged bank remodeled its relationships; cultivating relationships by favouring, terminating relationships by coercive isolating and neglecting relationships by benign neglecting.

Cultivating Relationships – by favouring

This mainly took place within the existing customer base of Bank A. The relationship cultivation took place within a comprehensively supporting framework. Two types of supporting emerged; overt and covert. Of the two types of supporting behaviour covert supporting was much more important.
Overt supporting occurs mainly by recognizing. Recognizing happens when the bank goes out of its way by offering invitations to the favoured few to corporate functions and be on the

receiving end of other forms of overt corporate hospitality. Although overt supporting has an important role in cultivating relationships it is much less significant than overt supporting.

Overt supporting happens first by assessing their favourability and then if established continues in three main ways; deal sweetening, customizing and entitling. Not surprisingly favouring by the ascendant bank tended only to happen with those clients it had developed an established relationship with prior to the merger. Favouring occurs when the dominant partner extends goodwill beyond their contractual obligations. Before favouring can happen it must be proceeded by a credibility audit. This audit encompasses both the tangible and intangible aspects of the relationship. The tangible aspects are the track record of banking behaviour by the client. The intangible aspects involve making assessments of the banking clients attitude to risk and as well as the bank's ability to understand their clients business in such a way that enables them to build and sustain trust. Once a favourable assessment has been established then the bank chooses one or all of the three covert supporting strategies to employ. Deal sweetening is the easiest option to use because it has the least risk to the bank. Deal sweetening involves offering special and privileged banking terms to others associated with the bank's clients. An example of this would be for a bank to offer all employees of the bank's clients earning over an agreed threshold low mortgage interest rates. In return the bank's expectation would be that it would lock the client into a longer term relationship. Deal sweetening was only offered to those clients who had been earmarked for a longer term relationship. Another option for the bank to covertly support its favoured clients was to offer customization. This happens when a special type of service is offered which is based on client needs rather than bank requirements. An example of this might be the synchronization of assessment of interest rates offered with the calendar dates of the clients annual general meeting. The bank might also agree to allow the delivery of services via the internet which were traditionally done by face to face meetings. The prestigious form of overt supporting for bank clients is entitling. This allows clients to be entitled to a great deal of flexibility over their total lending within a given period. For example the favoured client would be allocated an agreed amount of loan funds which the client [without needing to get clearance from the bank] decide which proportion will be used for overdraft, term loan or leasing. Only the favoured few received this facility.

Terminating relationships – by coercive isolating

In the immediate port merger aftermath the ascendant party becomes paranoid about the status 1,000s of unknown clients it has inherited from the descendant party. In a bid to gain control of a potentially chaotic situation it immediately begins remodeling all of the client relationships it has just inherited. Those clients that do not fit the risk profile are terminated. This research revealed that a process that I call coercive isolating carried out client termination. Three different types of coercive isolating emerged; stigmatizing, tainting and intimidating. Coercive isolating happens when the bank wants rapid closure on customers it no longer wishes to deal with. It is a freezing out process. Prerequisite of any relationship termination is stereotyping. The bank uses various kinds of formularistic preconceived profiling to screen and identify those clients, which do not conform to the norms they established in the default remodeling process. Once identified the customer is eliminated. The problem for the client is that they have no prior knowledge or understanding of the criteria, which are being used in the profiling process. By the time they realize what is happening they have been terminated. This research revealed that several medium sized companies that had been trading for more than 10 years were suddenly facing bankruptcy all because a bank merger had happened.

Stigmatizing
Having been targeted for elimination the bank then deliberately makes all its profiled clients feel isolated and unwanted. It does this in a number of ways. It will demand the immediate withdrawal of all overdraft facilities within 24 hours. It will renege on previously agreed lines of credit and seek immediate renegotiation of all other forms of prearranged lending. In the immediate aftermath of the merger the process is swift and brutal to all those who were clients of the descendant bank.

Tainting
When a client of the descendant party has an existing commercial agreement and way of working with its bank it erroneously assumes that in the post merger situation things will continue as before. All clients of the descendant party are first treated with suspicion. These clients become tainted by their prior association with the descendant party and are treated with mistrust.

Intimidating
If the unwanted clients of the descendant party have still not been eliminated by stigmatizing or tainting then intimidation is sometimes used. Sometimes there are clients of banks who manage to run up debts, which are larger than the net residual value of their tangible assets. In such cases should the bank foreclose on these assets the bank would make a considerable net loss. In these situations the bank would typically demand a "work out". This means that the client would be allowed to carry on trading and have all debts suspended until trading conditions improved sufficiently for the debt repayment to continue. However clients with potential "work out" situations often take the precaution to ensure that their personal finances are kept quite separate from their corporate finances of their business. This limits the maneuverability of the bank to intimidate them. Instances were found where the bank used potentially embarrassing personal information to pressurize the clients to make a financial contribution to their business from their separate private funds.

Neglecting relationships by benign denial

Relationship neglect happens when the clients from the descendant bank are considered to of special importance. Although these clients do not represent any financial risk to the bank, the bank has lost all interest in them because they fail to comply with the remodeled profiles. Three categories of benign denial were found; misunderstanding, distancing and impeding.

Misunderstanding
This is the deliberate process of choosing not to understand the business models of clients the ascendant bank have inherited from the descendant bank. This happened to clients who had businesses not in conventional manufacturing or retailing. Consultants with very few tangible assets or designers with a very large intellectual capital but few tangible assets were typical of misunderstood clients. The ascendant bank did not seriously consider the intangible net worth of such clients and whilst they made little effort to directly terminate the relationship they did nothing to sustain it either.

Distancing
The problem for the client that has been distanced by the bank is that it sometimes can take them quite a while to figure this out. This form of benign denial means that the bank has suddenly gone deaf to all their requests and instead just tolerates them rather than giving them what they have a reasonable expectation to expect out of such a relationship.

Impeding

This is an extreme form of benign denial. Here the bank deliberately blocks a business transaction in which they are no risk implications for the bank. An example of this might be the formation of a joint venture with a third party in a foreign country. The main problem for clients was that the bank never gave any prior warning or indication that certain types of business sectors or geographic regions were off limits. In stead the bank impeded without warning. It is normal business practice for the lead bank to give a bankers reference to the foreign partners lead bank prior to the formation of a joint venture. This research revealed cases where this process was impeded by the refusal of the clients lead bank to give the necessary bankers references. This tended to happen when, as apart of the default remodeling process, the ascendant bank would profile certain countries or business sectors that it had no desire to have its clients be involved with. This happened even though there was no financial risk or exposure to the bank. As a consequence the bank blocked some potential joint ventures. Impeding had a very negative strategic effect on profiled clients. It cast doubt on their commercial standing and credibility of it business and gave all the wrong signals to potential new business partners.

<u>How the core variable emerged from the use of orthodox grounded research methodology</u>

An orthodox grounded theory research method was used in this research [Glaser & Struass(1967), Glaser(1978) (1992)]. This meant that the research was not preceded by a literature review. Grounded Theory is a research approach, which has the potential to discover latent patterns of human behaviour from empirical data. It is an inductive research methodology that yields empirically grounded and robust hypotheses. There are two important characteristics of this research methodology that make very specific demands on the researcher. Firstly, the researcher must understand that orthodox grounded theory is a delayed action methodology. By this I mean that deeply embedded latent and subtle patterns of human behaviour will always be problematic to reveal. This is because most researchers will find it almost intolerable suffering the psychological regression associated allowing data to yield its own patterns of human behaviour. Instead would prefer to impose some external rationale. The process of figuring out these latent processes would be severely impaired by the prior use of a literature review. This is why no literature precedes the research. Secondly, the researcher must try to avoid researching contexts with which they have great familiarity. This is because if the researcher is investigating a context and data that they already have a great deal of prior knowledge it will blur their vision and make them succumb to too many preconceptions. This will often lead to the formation of elaborate descriptions rather than the emergence of authentic conceptual explanations.

The research project took place from 1996 to 1997 and was funded by the European Union Human Capital and Mobility programme[ERBCHBGT 9400637]. The decision to research a bank merger was opportunistic. A mutual friend introduced me to the chairman of a bank. Following which, I negotiated a research project to discover what happened when two major universal banks merge.

It is quite difficult to fully represent the Grounded Theory methodology [GT research] in a single diagram because of its dynamic process. However there are always particular phases which are necessary to do when carryout GT research. The data collection phase involves writing a series of theoretical memos from which indicators of the latent patterns of behaviour will eventually emerge. The data collection process in the GT research method is done by theoretical sampling. This means that the researcher has to write theoretical memos on all the

data that is collected. From these theoretical memos indicators emerge which give new directions for further data collection. These indicators are triggers for more data collection that assist the researcher to move from open coding to selective coding. Concurrent with these activities is the process of the constant comparison. To co-ordinate all these actions the researcher must write a series of systematic theoretical memos. From within these theoretical memos the transformation process from selective coding to theoretical coding and finally to the emergence of the core variable happens. One of the main processes of the GT research method, which makes this possible, is the process of sorting. The memos are systematically sorted to discover which variable can account for most of the variation in the data. When the core variable has emerged the GT process is complete. In this research the core variable was default remodeling.

I was able to have access to all members of staff from the boardroom to the retail bank front line staff. This access applied to both Bank A and Bank B. The research was a qualitative study, which involved collecting data by individual interviews, group interviews and participant observation. Initially I tape-recorded the first few interviews with specific individuals. I soon stopped this practice because it was having negative effects on both the respondents and myself. Taping interview impacted on me negatively for four main reasons. Firstly, it made the data collection too skewed towards my own research interests rather than the main concerns of the respondents. Secondly, the settings for the interviews were too formal. Thirdly, it stifled my intuition and creativity. It did this because I became a little complacent during the interviews knowing that it was all being taped and I could always listen to it later. Finally, it became very time consuming to replay the tapes and then try to make sense of them. The taping also affected the respondents in three negative ways. Firstly they always felt that they were being “interviewed” rather than having a conversation. Secondly, they were concerned that their superiors would get a copy of the tapes and adjusted their comments accordingly. Finally, the tape recording had the potential to be a barrier between the respondents and I. This limited the quality of participation they might give.

As well as disposing of the negative aspects dropping the taping had several positive out comes for me. Importantly it forced me to concentrate much more on what the respondents were both saying and not saying. It made all the “interviews” become more like “conversations”. The encounters were shorter, more frequent and more spontaneous. They had to be brief because I had to document the “conversations” as soon as possible after they had happened. During each of the several private notes taking session I had following the interactions with respondents I was able to operate on several different levels simultaneously. I documented their comments, noted gaps in what they failed to say, started to build a list of issues to follow up on in the next encounter. From the first encounter I was writing grounded theory memos. Some were a few lines and other were several pages of notes. The note taking was then later written up in the form of theoretical memos. In these memos there were separate sections for issues that were empirical, conjecture, unanswered questions as well as links inserted to other theoretical memos, which were also emerging. Once I had assembled a stack of memos I began the process of constant comparison. Here variables across the memos were closely scrutinized to see if any latent patterns and similarities were emerging. Once these began to emerge I then started to collect more data specifically related to these selective codes. Finally default remodeling did emerge as the core variable. This was because default remodeling explained most of the variation in my data. I was able to begin to predict patterns of behaviour by the newly merged bank . I was able to do this because the research had revealed a latent pattern of behaviour that I call “Default Remodelling”.

Implications of the research for business to business relationships

Mergers are momentous events. The concept of a Merger is a myth. Mergers are takeovers by stealth. The ascendant party, in the merger, uses its newly acquired power by redesigning all of its client and business to business relationships by default remodeling. In the immediate aftermath of a merger the ascendant party default to their basic, tried and tested traditional values. These values are systematically enforced through the socialization of the three different and parallel processes; cultivating relationships by favouring, terminating relationships by coercive isolation and neglecting relationships by benign denial. The innocent victims of the post merger aftermath are far more wideranging than was previously reported in the literature. All those who had a close relationship with the descendant party post merger are the most vulnerable. These include not only employees and clients but also suppliers and other business partners. This vulnerability has intensified with the increasing tendency for clients, suppliers and business partners to establish and maintain long term relationships. In order to ameliorate the impact on default remodeling vulnerable clients, suppliers and business partners should establish and maintain parallel and simultaneous relationships with different business partners from within the same business sector prior to any merger activity. In a post merger context vulnerable parties should be understand how best to predict the which is the ascendant party. There are five indicators that identifies which of the two parties has become ascendant party introduce default remodeling post merger;
[1] The location of the new head office
[2] The dominant legal framework that is being used post merger
[3] The name and prior allegiance of the new CEO and president
[4] The type of IT system that is being used post merger
[5] The name of the newly merged entity

Implications for academics teaching and researching in business schools

Business schools tend to teach and research mergers as a technical market mechanism with little acknowledgement of post merger consequences. When a greater understanding of the impact of mergers has on specific business sectors then assumptions of the efficiency of the market mechanism will be treated with due skepticism. As globalization progresses the incidence of mergers will accelerate. Hence the urgent need for business schools to teach and research mergers from a more empirically based focus.

Comparative literature review
The purpose of a literature review with the context of an orthodox grounded theory research design is to establish where the emerging theory is situated within existing bodies or relevant literature. Mergers and relationship marketing will be the focus for this comparative literature review

The increased incidence of mergers has been acknowledged by Gray(1989), Crane and Brodie(1996) and Hislop(1996). Textbooks on mergers and acquisitions such as Cooke(1988) are focused entirely on the technical and financial logics of mergers and acquisitions. They ignore the impact mergers have on the non-financial institutional clients or suppliers. A notable exception to this are Hapeslagh and Jemison(1991). These authors make a genuine effort to unravel relevant data, which relates directly to the post merger aftermath. Unfortunately their data relies heavily on secondary data and their primary data sources are very limited and incomplete. In addition their research is deductive and they bring to their research an agenda that clouds their ability to discover what is really going on. As a consequence the full impact of mergers on clients and suppliers is missed. Gill(1978) has

drawn attention to the requirement of senior personnel officers to be more involved in the internal organizational issues at an earlier stage of the merger than is often the case. The reason why the Gill(1978) logic is unlikely to happen is because it underestimates the power of the corporate trauma of the immediate post merger situation, which is only resolved by default remodeling. In all the literature on mergers no authors have made a connection between the increased vulnerability of innocent victims and their association with the descendant party.

Relationship marketing is still in its early stages and has either been developed by preconceived deductive conceptualizations [Gronroos(1996), Gummesson(1995) and Sheth and Pavatiyar(1995)] or by deductively derived research [Lijander and Strandvick(1995) and Holmlund and Kock(1996)]. Both these two approaches to understanding relationship marketing have yielded descriptive structural frameworks based on the research agendas of the professional research community. What they have failed to do is to reveal and explain the agendas of those people who are actually experiencing the impact of relationship marketing. Lowe and Glaser(1995) have highlighted the important role that grounded theory research could have in the understanding of relationship marketing. An outstanding example of the power of grounded theory research in this field is by Guthrie(2000). Guthrie's(2000) inductive empirical research explains that relationship marketing is a euphemism for "client control". "Client control" clearly forms an important part of the default remodeling process.

There are some interesting comparisons, which can be made between deductively derived conceptualizations of the structure of relationships [Lijander and Strandvick(1995)], and the inductively established processes of relationships in default remodelling:

Lijander and Strandvick(1995)	Default Remodelling(1997)
Valued relationships	Cultivating by favouring
Forced relationships	Terminating by coercion
Indifferent relationships	Neglecting by benign denial

The above comparison demonstrates the power of Default Remodelling's conceptual explanation over Lijander and Strandvick's (1995) conceptual description. A conceptual explanation enables those involved in mergers to predict future behaviour and thus ameliorate the any impact default remodeling may have on them. A conceptual description is intellectually interesting but has no utility value for those in a post merger situation.

Previous inductive research by Simmons(1993) found that the process of relationship cultivation was in a four stage cycle. Default remodeling agrees with both Simmons(1993) and Guthrie(2000) that relationship marketing is a highly manipulative process which is far more to do with "client control" than "relationship marketing". The basic social process of default remodeling originated from the context of a bank merger. Since its original publication Lowe(1998) default remodeling has been demonstrated to be fully present across a broad spectrum of merger situations. This has been established by several commercially confidential business consultancy projects I have carried out in the US paints industry, Eurozone internet banking sector and the Asian personal insurance services.

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