A GUIDE TO SUCCESSFULLY EXECUTING A MERGER OF EQUALS
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INTRODUCTION

As financial institutions come out of the pandemic and face the reality of a revenue recession, the need for scale and the related cost efficiencies have driven larger community and regional banks to be more open and to execute “mergers of equals” (MoEs). Recent announcements about mergers of equals across the U.S. banking industry underscore the promise of these transactions while perhaps recognizing the challenges of bringing two like-sized institutions together.

The number of mergers of equals since the beginning of 2021 is in the double digits. This dynamic started before the pandemic with BB&T and SunTrust in 2019; 2020 was effectively a pause before activity picked up again in 2021. In just the last few months, several such mergers have been announced. Webster Bank announced a merger with Sterling Bank. The all-stock transaction creates a $63 billion bank headquartered in Stamford, Conn., with locations across multiple states in the Northeast.

A comparable merger of like-sized banks in the Midwest involving Old National and First Midwest would create a financial institution with an estimated $45 billion total assets with dual headquarters in Evansville, Ind., and Chicago, Ill.

Likewise, $28 billion BancorpSouth, based in Tupelo, Miss., announced plans to complete a merger this year with $18 billion Houston, Texas-based Cadence Bancorp. The South also saw SouthState Bank and CenterState Bank complete operational integration for their MoE in mid-2021.

Regional banks are not the only institutions pursuing such mergers. Virginia National/Fauquier and Blue Ridge/FVCbank are two examples in the community bank space looking to build scale and create strong operating leverage while building the resources to invest in technologies that will attract and retain customers.

With their emphasis on big numbers and the promise of future earnings growth, these announcements may skip over the hard work that went into reaching consensus on the framework for the mergers and a roadmap to bring two boards and leadership teams together.
Post-announcement, the next stage begins to integrate management teams and the employee base, create a new corporate culture, and consolidate physical and technological infrastructure. The to-do list leading up to the close date will present challenges and sometimes contentious quandaries well beyond the scope of much more familiar acquisitions of smaller banks by larger institutions.

Merger discussions between unequal-size banks are typically founded on some basic assumptions: the leaders of the larger institution will continue in their roles post-merger of a bank with the same name in the same headquarters operating the same technology systems so that the consolidation is accomplished with as little disruption as possible for the majority of customers and staff. There are exceptions to this common scenario, but in general, when both parties accept these suppositions from the outset, they sidestep some potentially steep hurdles.

The to-do list leading up to the close date will present challenges and sometimes contentious quandaries well beyond the scope of much more familiar acquisitions of smaller banks by larger institutions.

In a prospective merger of equals, on the other hand, answers to the questions of who will lead the continuing organization, how it will be branded, where it will be based, and what systems will support operations are less clear-cut. These conversations take place in an atmosphere of mutual respect for what each organization has achieved through its unique blend of leadership, strategic execution, and successful delivery on its brand promises. The idea of joining forces is put forward as a bold next step, an opportunity to move beyond what each institution has accomplished individually. But difficult choices are ahead to translate that potential into reality as leaders for both banks negotiate:

- Composition of the board and management teams;
- Hierarchical and organizational structures;
- Administrative office, operations center and retail outlet locations;
- Technology systems best suited to power the operations of a financial institution that will literally double in size overnight; and
- The cost saves promised to the Street.
Settling some fundamental issues early on and clearly communicating those decisions when the merger proposal is announced can help create a firm foundation for the work that will be done in the months leading up to close. Big-picture views of the leadership and primary markets to be served by the new bank, along with a framework for answering other consequential questions, are essential building blocks for an efficient, effective path to consolidation.

**Announce key leadership positions as quickly as possible.** “There’s always the perspective of who’s going to win and who’s going to lose in these situations,” notes Onker Basu, senior director with Cornerstone Advisors’ Strategy and Execution team. “Setting the right tone early establishes a platform for continued progress toward integration and a smoother merger as time goes on.”

**Address the social and political commitments** that have been made in the case where the merger partners currently operate in both overlapping and disparate locations. The potential for job loss will be a dominant concern among managers and staff. Infrastructure decisions “are not always driven by considerations of the most efficient or cost-effective way to do business, but they certainly impact the potential for a smooth transition and approval from regulators down the road,” Basu says.

**Establish a decision-making process to guide merger teams to a successful conclusion.** Even after those initial big decisions, “the next level of detail is oftentimes the knottiest for people to get their heads around quickly,” says Vincent Hui, managing director leading Cornerstone’s Merger and Acquisition practice. “Those decisions are crucial because a lot of integration activity hinges on them. The longer it takes to make those decisions, the greater the risks will be to the integration process. That’s why it’s important that a governance and decision framework is defined early on.”

One early decision involves developing an internal communication plan for disseminating the establishment of and progress toward milestones for the timing of merger tasks. What actions need to be completed when? These executive-level decisions need to be communicated promptly to prevent wasteful, idle “cooler talk,” Basu says. Anxieties over the unknown can distract employees from completing important tasks.

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Develop and articulate a project and program management structure with leadership from both sides.

This organizational plan should spell out clear roles, responsibilities and reporting structures along with decision variables, methods and metrics.

Mobilize quickly and commit to forward progress.

“Oftentimes after a merger is announced, people want to catch their breath, but you need to move quickly on to the next steps or risk losing momentum,” Hui recommends. “As you convene transition teams, make sure the tone highlights collaboration. For example, you can’t have committees that are unbalanced. They need to represent both organizations. A steering committee with five people from one organization and two from the other sends a message that this is not really a merger of equals.”

Along the same lines, leaders need to be mindful of terminology. In a merger of equals, the word acquisition should be stricken from leaders’ vocabulary. “People pick up on those little things,” Hui notes.
WHAT WILL THE NEW ORGANIZATION LOOK LIKE?

From the designation of departments to realignment of individual duties and titles, organizational restructuring is one of the most important—and potentially contentious—aspects of consolidation. What will the new corporate hierarchy look like? Which positions will report directly to the CEO, and who will hold those positions? How will divisions and business units align under various departments? What products and services will be offered? Which markets will be targeted for growth, and which may be rationalized out? How will the branch networks and online delivery channels be merged?

“Every bank organizes itself a little differently. Some departments may cover two or three areas of responsibility, while others may focus on just one,” Hui notes. “As part of the process of reorganization, planners should recognize the impact of the bank doubling in size, which may guide some decisions.”

Given the much greater volume of business post-merger, it may make sense to divide responsibilities once handled by a single business unit among two departments. For example, if the deposit operation currently also handles card processing, it might make sense following the consolidation, from the perspective of gaining economies of scale and adopting best practices, to reorganize with separate departments for deposits and card processing.

Another challenge is assigning titles in the new organization. Pre-merger, the head of lending in one bank might be a vice president, while the same position in the other bank is at the senior vice president level. In equalizing the position structure, a former SVP who will now assume the title of vice president may see the new title as a step back, when it is, in fact, merely a function of titling conventions in the new larger organization.

“In the grand scheme of all the changes under way, a new title may seem like a small thing, but it can be emotional,” Hui notes. “To aid in the transition, HR folks really need to take the lead in transparency and ensure that those decisions are made quickly and consistently and communicated effectively.”

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A related organizational issue often arises in lending: If one merger partner has operated with centralized lending, and the other’s loan operations are decentralized, settling on a strategy for the continuing bank can be a difficult decision, raising both organizational and cultural concerns. Loan officers who are used to one structure may have a hard time adjusting to the other.

“The challenges of that transition should not be underestimated. One possibility might be to look beyond the either/or choice to determine if there might be a third option, a hybrid approach based on loan products or markets,” Hui adds. “It’s important to emphasize that these decisions are not being made to make loan officers happy, but to provide the best possible customer experience.”

Employees’ concerns about how the merger will affect them professionally and personally are natural, and the leadership and transition teams should recognize that their decisions will likely result in some turmoil. A commitment to make decisions as expeditiously as possible and to communicate them clearly can help relieve some of that anxiety. At the same time, it may bear repeating that decisions about organizational structure are made, first and foremost, for the good of the new bank and its customers.

Any managerial tendency to guard one’s turf should be set aside with the understanding that no one will lose under the merger and everyone continuing with the organization will gain, Hui suggests. “There will be twice as many customers to serve and twice as many transactions right out of the gate.”
Soon after a merger is announced, the joint technology integration team can begin its work with a thorough inventory of the application and infrastructure portfolios of both banks. A comparison of core processing systems is often the first order of business. The impact of doubling transaction volume is unlikely to tip the balance in favor of a particular solution, as many core systems should be able to handle the additional load, says Quintin Sykes, managing director with Cornerstone’s Technology Solutions practice. Instead, these factors are more relevant in determining which core system provides the best fit for the post-merger financial institution:

- **Products and services to be offered by the continuing organization**
  “If one institution has a huge mortgage servicing portfolio or a deeper mix of commercial lending, complex credits and treasury management, the core system will need to support those products,” Sykes says.

- **Compatibility and integration with preferred digital banking solutions**
  If one or both merger partners rely on the delivery channel systems offered by their core providers, the integration team will likely evaluate the core, online and mobile solutions as a bundled package. On the other hand, one or both partners may be running a best-of-breed digital channel solution with more sophisticated service offerings. If the combined bank aims to offer that solution to its customer base, that decision emphasizes the need for a core system that supports third-party integration and preferably has been integrated with the desired digital channel solution already. The same would be true if components of the planned solution set involve integrating other best-of-breed solutions. The goal is to avoid unpleasant surprises in the form of significant delays and cost overruns during system conversions.
• Input from system users
The integration team must work closely with other departments in evaluating functionality of the competing core systems for their operations and systems that interface with the core. “This decision can’t be made in a vacuum,” Sykes says. “If one institution has all these other systems wired into the core that offer superior performance and are working well, that may tip the preference.”

• Contractual considerations
The costs of early contract termination with a core, loan origination, digital channel or other technology provider can be significant, to the point of taking priority over functionality considerations. “If it’s going to cost $4 million to get out of a digital banking contract, the continuing organization may be better off keeping that system, at least in the near-term,” Sykes notes.

• Market trends
Post-merger, the combined bank will be operating at a new scale, so it may be instructive to look at what core systems other like-size financial institutions have chosen to run their operations. “A lot of factors come into play when you’re finalizing what that solution set looks like, but at the end of the day, it’s about functionality, integration, cost and breadth of services,” Sykes adds.

In tackling the full complement of technology required to run a modern financial institution, Cornerstone Managing Director Ryan Rackley suggests a three-step contract due diligence process to aid in evaluating systems currently operated by both merger partners:

1. Rank the systems by annual costs, based on accounts payable data sorted by vendor in descending order.

2. Identify contract lifecycle details to compare the likely costs of continuing or ending those vendor relationships. For each contract, list expiration dates and initial estimates based on anticipated conversion dates in terms of liquidated damages, deconversion fees and other costs. Early termination penalties and the costs involved in transferring, cleaning up and testing data during a system conversion may be high enough to sway the selection or timing of system integration.

3. Assess the features, functionality and pricing of like systems to rank which options would be most closely aligned with customer service strategies, system capabilities and cost efficiencies.

It might seem that an objective side-by-side comparison of technology systems should be a straightforward exercise, but emotions can get in the way, Rackley cautions.
“You’ve got people who are highly passionate and have built their bank on being successful in the market. That passion may come shining through in these discussions, which isn’t necessarily a bad thing,” he notes. “As an example, if you’re the line of business leader for a commercial digital product that’s been successful for your bank, you want to see that solution survive. And on the other side of the table, the business leader for the other merged bank is thinking the same thing.”

As a result, the new organizational chart may influence system selection for the combined institution because “the loudest voices in the room want to align their talent and their people” with the solutions that will be in place in the continuing organization, Rackley says. That means decisions may not be based on evaluations of functional fit with the new bank’s technology requirements.

Working with an expert third party through the processes of system selection and contract negotiations can help provide an objective perspective and an insider’s view of market pricing, Rackley adds. An experienced business partner can help technology integration teams and executives set up effective decision-making processes and navigate the novel challenges that may arise in a merger of equals.
The bottom-line conclusions of these evaluations should provide a sound basis for renegotiating contracts with key technology vendors. “You’ve got a finite amount of time—our structure is a 100-day framework—for ‘capturing the bogie’ or fulfilling promises that a merger of equals will create value in terms of vendor cost reductions,” Rackley says. “That’s typically a number, but also a timeline of how quickly the merged institution can drive those vendor cost savings out of their technology contracts.”

Estimates of vendor cost reductions are based on rough calculations of savings through cancellation of contracts for duplicate systems, volume discounts and renegotiated pricing, offset by contract termination fees and conversion/deconversion costs. In a merger of equals, this due diligence process will likely identify about 20 contracts—for the core, online and mobile banking, treasury management, card processing and telecom systems, to name a few—to target for renegotiation in advance of the official merger date.

“A bank has hundreds of vendors that it uses to run the institution, but the top 20 are the ones you want to focus on—those that are highly negotiable, based on services rendered, that you can drive creative economies of scale to bring down costs,” Rackley says. “We operate in an opaque market. Vendor technology is a business-to-business, highly service-driven market. As you go through a merger of equals, a highly anticipated deal within the market, it’s anticipated that no one is going to pay Maserati prices for a Cadillac system.”

The average timeline to select and negotiate a contract for a core system in the financial services industry is about nine months, he notes. A bank merger team has only about a third of that time to choose, not only the core but all technology systems, and renegotiate pricing and contract terms for the most critical systems.

In warning against cutting corners in that process, Rackley uses the metaphor of a dance. “You can speed up the tempo, but you cannot skip steps and expect to end up in the right place,” he advises. “The key components—the proper due diligence, financial reviews and evaluations—all still need to happen.”
And along with those requirements, the team will also need to negotiate the conversion statement of work (SOW) for professional services in parallel with contract conditions. The SOW sets out the responsibilities of vendor teams to assist in merging accounts onto the combined platform, based on the merger timeline and the assumptions built into the case for consolidation that savings will be attained by a specified date, typically within nine months to a year of the legal close.

“As you’re negotiating contract pricing, you’re also negotiating that conversion statement of work so that it also enables immediate mobilization of the conversion teams once pricing has been settled,” Rackley explains. Thus, negotiations bring together parallel efforts for the technology conversion and mobilization efforts as well as the legal review of business terms and conditions for system contracts—with the aim of netting the bank three months of conversion mobilization and planning efforts while the contract is being finalized.

The bank’s negotiating team should focus on contract terms that provide for flexibility in a merger of equals and anticipates future M&A activity. Among those terms and conditions, new pricing should be clearly documented and easy to understand, setting out any incentives that were negotiated for the new, reduced contractual run rates. As negotiations move briskly forward, daily discussions are fairly common to keep pace with the tight timeline, so the bank team needs to ensure that agreed-upon pricing is thoroughly and accurately documented, Rackley recommends.

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Future contract termination and deconversion fees are another crucial topic. “Like everything else in the world, contracts have a life cycle, and it is important to negotiate that full life cycle, anticipating the possibility of future changes through another merger of equals or significant acquisitions,” Rackley notes. “The team should negotiate terms for liquidated damages in the deconversion fees up front before the contract is signed. That’s when the leverage is the highest.”

A third important area involves “double-dip protection,” which might arise in a situation like this: Down the road, the bank acquires another financial institution using the same platforms and systems that are in place today from the same vendor. The contract clause should insure that the bank does not have to pay for an account twice, i.e., once under the previous bank’s liquidated damages and once under the new account pricing.

Service-level agreements should also be scrutinized. “When transaction volume essentially doubles overnight, it needs to be talked through and agreed upon at a detailed, granular level how the system’s going to be implemented,” Rackley says. “The bank will be relying on its vendors to execute and pull on the technology put in place by the merger. Service-level agreements must be clearly documented for key platforms, specifying fee credits upon service-level misses up to and including a termination option for chronic problems.”
In addition, the bank’s team should negotiate growth tiers into the fee structure for the transaction volume after the consolidation to encompass future anticipated growth, with the aim of planning for and minimizing costs as the bank continues to expand its market and acquire other institutions over the contract term.

Finally, negotiations should address annual price adjustments, which are commonplace in contracts today. The bank team should work to keep these built-in cost escalators as low as possible. “Vendors want to protect themselves from inflationary increases of their cost structures, but from the bank’s side of the table, negotiators want to ensure that any annual price increases for the same services and same volumes over the contract term are minimized,” he advises.

In these contract negotiations, the bank team should look to press its advantages of choice between the systems now in place with each vendor, understanding that if there are two core vendors in play, one stands to gain market share with little acquisition costs.

“The merged institution is in a highly leveraged position,” Rackley adds. “It will pick one platform, and that one platform is going to have double the volume of what it had yesterday. But the decision needs to happen quickly because there’s been public expectations laid upon the market to do so.”
Finalizing system selection sets the stage for other key decisions, including the size and makeup of the information technology (IT) team that will run the combined portfolio and the administrative locations of technology operations. The size of the IT department of the combined bank will be determined less by the increase in transaction volume across systems and more by the number and complexity of those systems, the infrastructure required to run those systems, and the user base that will require IT support.

Support personnel with experience and expertise with the continuing systems will be needed moving forward, but geography is also a factor. If the bulk of technologies that will serve the continuing bank is in one location, it may make sense to train the existing team based there on the solutions that will power operations going forward. Or the organization may be best served by diversifying its talent base and IT infrastructure across multiple locations, which support business continuity planning and may provide access to additional talent markets.

As with system selection, a variety of factors must be weighed in assembling the IT team. At the executive and top management levels, leadership and talent development capabilities are often more prized than system expertise, while the right mix of technical skills will guide other staffing decisions.

“If the people on staff at one bank already know a key system, the decision may be to keep them. At the same time, the combined bank may have other people with a high potential to do well with a variety of systems that managers want to ‘train up,’” Sykes notes. “And you may also need to consider a new organizational structure for the combined bank, in comparison to an institution half that size that didn’t have a robust project management office or a solid IT operational risk management function. Looking outside at what comparable organizations have is helpful in deciding what new roles you’ll need to fill.”

Once those longer-term structural and staffing decisions have been made, IT and human resources (HR) leaders must work together in quick order to develop short-term retention offers for the technology professionals whose skillsets will be needed through the merger integration process. Even if their positions may not continue, these team members can offer valuable expertise in the transition, and there may be opportunities for them to join the continuing organization in new roles or unexpected job openings.
The same goes for other departments, Basu notes. “You may have managers and executives who can make valuable contributions in preparing for the combined organization—so identify these players, too, and develop a plan to keep them on and reward them appropriately for that work.”

“You need to be open and honest about who’s likely to stay and which positions may not continue, so you can identify a retention strategy to reward people who can contribute value at this stage to stay on,” he adds. “Otherwise, people will leave quickly in response to uncertainty well before the close date.”

Without a retention strategy in place, transition teams may quickly find themselves lacking critical knowledge and staffing to the point of causing setbacks in the merger process. Elements of this strategy may include meaningful bonuses tailored to the needs of individual employees to keep them on board through critical periods, potential opportunities for talented employees to apply for other positions in the continuing organization, and support and assistance for employees seeking positions elsewhere.

**Without a retention strategy in place, transition teams may quickly find themselves lacking critical knowledge and staffing to the point of causing setbacks in the merger process.**
The culture of the new bank is more intangible than its organizational structure and technology base but no less important. A well-defined and proactively nurtured culture can mean the difference between merger success and a negative atmosphere that can linger and drag down performance for years to come.

It’s worth the time and effort for the continuing institution’s executives to identify the prominent aspects of each bank’s current cultural DNA and to agree on how to weave the most desirable and productive characteristics from each into the new organization.

As just one example, corporate culture may show up in the tenor and focus of business discussions. Are they driven by performance metrics or “softer,” more subjective considerations? Is one bank more risk-averse, while the other is open to experimenting with new products and processes? Is one workplace atmosphere more formal and the other more casual? There are no rights and wrongs here, but conflict and unease may arise over these differing approaches if leaders do not address the cultural expectations for the combined bank.

“Everyone looks to the executive team to take the lead on defining and modeling culture to see what kinds of behavioral patterns they demonstrate,” Basu says. “If employees see overt confrontation, passive aggressive behavior or simply a lack of cooperation among executives, that can drift and pervade interactions at all levels and have a negative multiplier effect across the organization. It is essential to address culture in concrete terms and then demonstrate at the top how the defined culture dictates collegial interactions and decision making.”

Prompt decisions and clear communication about governance of the new bank will help maintain a positive culture, Hui suggests. “The more you delay, the more uncertainty that arises and the more risk there is that people will be leaving, including top performers.”
Differences in corporate culture may also be evident in how decisions are made in the two organizations. Trade-offs in the emphasis in decision making generally fall into three categories: (1) economic or financial impact, (2) customer experience, and (3) risk and controls.

“Generally, all three categories are considered. It’s never equal emphasis on all three, and the degree of emphasis on these factors will likely vary from issue to issue,” Hui says. “But how much emphasis a bank tends to put on one of those areas can be very telling. If one bank is more customer-oriented and it shows in management decisions and the other is more risk-oriented, there’s likely to be some culture clash that will need to be addressed up-front.”

A simple, practical example involves procedures for expense report reimbursement. Hui worked with a client company where managers all the way down the hierarchy approved expense reports. When the company changed that process, managers were upset over the perception that more controls were being placed on their authority. On the surface, these kinds of changes may not seem like a big deal, but they can raise the ire of employees of one or both merger partners.

These issues may be multiplied in mergers of equals because so many more people are affected. One way to manage those potential conflicts is an increased emphasis on change management. “It’s about communicating change and engaging the right influencers to be proponents of change,” Hui notes.
Does prior experience with acquisitions of and mergers with smaller organizations provide useful information to apply to mergers of equals? There are some parallels, Basu says, mainly on technical issues such as the mechanics of data conversions and branch rebranding. Executives may also be able to apply their prior experiences in executing on cultural integration, but they will likely need to proceed with more caution in introducing cultural elements that will likely be new to employees of both merger partners.

Hui applies the Pareto Principle to compare how much of traditional M&A expertise may be relevant in a merger of equals: About 80 percent of an acquisition and a merger of equals involves the same decisions and processes, but the remaining 20 percent is so different when bringing together like-size organizations that this endeavor requires a new approach and careful attention to setting the right tone and sending the right messages.

“In the first 60 days, you need to mobilize quickly, so it can be beneficial to look to people who’ve been there before to help set the right tone,” he says. “Many mid-size banks have been through several acquisitions, but leaders do need to recognize the differences in these larger-scale transactions. They should recognize the potential for emotional responses across the two organizations and aim to set the right tone for the merger and maintain it throughout the transition.”

In both cases, time is of the essence. Basu comes back to the imperative in achieving a successful merger of equals to agreeing on key guiding strategic principles at the executive level that will help drive prompt decisions on product lines, organization, technology and infrastructure. Agreeing on those principles about the central goals for the merger will help guide effective decision-making and head off endless, unproductive debate.

“The same thing goes for business lines: Are you going to retain the products of Bank A or Bank B, or are you going to integrate the new bank’s product lines?” Basu says. “Those issues need to be decided and articulated very quickly so you can move customers over to the right products seamlessly and with minimum disruption. Those are mechanical issues but are equally important to the merger’s success.”
When two comparable banks join forces, the expectation is that they will take full advantage of the doubling in scale to optimize the value delivered to shareholders and customers. Only careful planning and execution will enable the two banks to realize the promise of a merger of equals.

It's no easy feat to agree on the high-level framework—the consolidated bank's leadership team, brand and base of operations—that is unveiled when the merger is announced. But even tougher decisions lie ahead in the months leading up to the formal close, as transition teams representing both institutions work together to devise a new organizational structure and management teams, plan the physical and technological infrastructure, and attain accretive value hidden in vendor contracts.

The building blocks for the new bank come from the best of both merger partners: the most talented and productive people, high-performing and cost-effective systems, and a blend of popular products, services and delivery channels. A key to success will be moving beyond the boundaries of “your bank” and “our bank” and uniting in a collective goal to be the newest force in the financial marketplace.
ABOUT
CORNERSTONE ADVISORS

At Cornerstone Advisors, our goal is to deliver tangible business impact to financial institutions. We know that when institutions improve their strategies, technology, and operations, enhanced financial performance naturally follows. Because we live by the philosophy that businesses can’t improve what they don’t measure, we show banks and credit unions how to use laser-focused measurement to make smarter technology decisions, reengineer critical processes, and develop more meaningful business strategies.
Have questions about this report?

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