

# Tying the Knot: A Guide to Mergers in Microfinance

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# List of Acronyms

<b>Asala</b>	Palestinian Women's Organization
<b>CEE</b>	Central Eastern Europe
<b>CEO</b>	Chief Executive Officer
<b>CFO</b>	Chief Financial Officer
<b>CORDAID</b>	Consortium on Relief and Development Aid (Netherlands)
<b>CRECER</b>	Crédito con Educación Rural (Bolivia)
<b>CRS</b>	Catholic Relief Services (USA)
<b>FFH</b>	Freedom From Hunger (USA)
<b>FIE</b>	Centro de Fomento a Iniciativas Económicas (Bolivia)
<b>FONDESIF</b>	Financial System Development and Productive Sector Support Fund (Bolivia)
<b>FORA Fund</b>	Merged entity of Opportunity International partners in Russia
<b>GE</b>	Goviin Edhlel (financial institution in Mongolia prior to merger)
<b>GGLS</b>	Group Guaranteed Lending and Savings (lending methodology used by Save the Children/US)
<b>GM</b>	General Manager
<b>GTZ</b>	Deutsche Gesellschaft für Technische Zusammenarbeit (German Technology Fund)
<b>Kamurj</b>	Bridge microfinance program (CRS Armenia)
<b>LID</b>	Local Initiatives Department, World Bank (Bosnia & Herzegovina)
<b>LIP</b>	Local Initiatives Project, World Bank (Bosnia & Herzegovina)
<b>M&amp;A</b>	Mergers and Acquisitions
<b>MDF Kamurj</b>	Kamurj Microenterprise Development Fund (Armenia)
<b>MEDA</b>	Mennonite Economic Development Associates (Canada)
<b>Micro-F</b>	Micro-Fund microfinance program (SC Armenia)
<b>MIS</b>	Management Information System
<b>MFI</b>	Microfinance Institution

<b>NGO</b>	Non-Governmental Organization
<b>NIS</b>	Newly Independent States
<b>OMB</b>	Opportunity Microfinance Bank (Philippines)
<b>PFF</b>	Private Financial Fund (legal entity for MFI in Latin America)
<b>PRODEM</b>	Fundación para la Promoción y Desarrollo de la Microempresa (Bolivia)
<b>SC</b>	Save the Children (USA)
<b>SME</b>	Small and Medium Enterprise
<b>TPC</b>	Thanakea Phum Cambodia (CRS Cambodia)
<b>USAID</b>	United States Agency for International Development
<b>WC</b>	Working Capital (USA)
<b>XAC</b>	Golden Fund for Development (NGO in Mongolia prior to merger)

# Glossary of Key Terms

**Achieving scale** – Reaching large numbers of clients, which usually results in increased outreach and efficiency.

**Arrears rate** – Measures the loan payments past due as a percentage of the total loans outstanding.

**Asset transfer** – A means of accomplishing a merger by transferring assets from one or more legal entities to another, whether by grant or sale. This includes the transfer of tangible assets such as moveable equipment, vehicles, and real property; and intangible assets such as cash, deposit accounts, contract rights (such as leasehold interests), and loans.

**Community bank** – A group of borrowers, similar to a village bank, usually in urban areas where the term "community" rather than "village" is more applicable.

**Contingency funds** – The amount of extra money set aside to pay unforeseen costs, in this case, during a merger process.

**Client retention** – Measured by the number of clients who continue to borrow, usually expressed as a percentage of total active clients.

**Delinquency** – Refers to the health of a loan portfolio; a general state where there are payments past due or defaults (unpaid loans), which will adversely affect lending operations.

**Due diligence** – The systematic investigation of another organization's legal, financial, and operational status.

**Financiera** – A type of microfinance company, similar to a Private Financial Fund, found in several countries in Central and Latin America, for example Paraguay and El Salvador.

**Internal account lending** – A practice commonly found in village banking methodologies where internal savings are collected and distributed among members in a village bank as "internal loans," in addition to the "external loans" received from a microfinance institution.

**Loans written-off** – Loans considered non-recoverable after a period of time.

**Localization** – The process by which an international organization transfers its programming to a local body within the country in which it operates.

**Merger** – The legal act of combining two or more separate entities into one entity with a single governing body.

**Portfolio at Risk** – Measures the loans outstanding which have one or more payments past due as a percentage of the total loans outstanding.

**Post-merger integration** – The process of streamlining systems, staff, procedures, and operations after the official transfer of assets from one entity to another entity.

**Private Financial Fund (PFF)** – A type of commercial finance company established in Bolivia that is allowed to provide money transfers, offer foreign exchanges services, receive savings and time deposits, and contract obligations with second-tier institutions. It is restricted from offering checking accounts, foreign trade operations, equity investments, and security placements.

**Reserve fund** – A portion of money set aside by borrowers to protect against possible future repayment problems or emergencies.

**Self-sufficiency** – The situation whereby income covers costs, including operational and financial costs. Commonly identified among microfinance institutions as a chief aim to ensure long-term programming.

**Solidarity lending methodology** – A lending approach in microfinance that uses small groups, usually of 5-10 people, who provide mutual guarantees of one another's loans.

**Strategic plan** – A document that spells out key decisions that need to be made before a merger can take place. It assigns roles and responsibilities for a due diligence team and prioritizes the major strategic and financial issues that need to be resolved.

**Sweat equity** – The amount of time burden that staff experience, in this case during the planning and integration process of a merger, which adds a significant unseen cost to an institution.

**Transition plan** – Also called an "Integration Plan" or an "Action Plan." A document that summarizes any key decisions made after the Strategic Plan and details any outstanding issues and activities with provisional deadlines for completing the activities.

**Village banking methodology** – A microfinance lending approach that uses larger groups (often 20-50 people, broken into smaller solidarity groups of 5 people) that provide a double level of guarantee for one another's loans.

# Contents

Acknowledgements .....	iii
Introduction .....	x
<b><u>Chapter 1:</u></b>	
The M&A Phenomenon: Should MFIs Follow Suit? .....	1
<b><u>Chapter 2:</u></b>	
Setting the Stage: The Armenia Context .....	11
<b><u>Chapter 3:</u></b>	
Merger Phase I: Deciding to Merge .....	19
<b><u>Chapter 4:</u></b>	
Merger Phase II: Getting Acquainted and Building Trust .....	31
<b><u>Chapter 5:</u></b>	
Merger Phase III: Strategic and Transition Planning .....	47
<b><u>Chapter 6:</u></b>	
Legal Aspects of Microfinance Mergers .....	67
<b><u>Chapter 7:</u></b>	
Culture Clash: The Human Side .....	81
<b><u>Chapter 8:</u></b>	
Merger Phase IV: Post-Merger Integration .....	93
<b><u>Chapter 9:</u></b>	
The Mechanics of Merging MFI Operations .....	107
<b><u>Chapter 10:</u></b>	
Summary and Conclusions .....	129
Selected Resources .....	138
About the Author .....	140

# Introduction

As more and more micro-lending schemes are established around the world, competition in the field of microfinance is growing fierce, raising the question for many microfinance institutions (MFIs)—which vary in size, quality, and donor funding—of whether they can survive in an increasingly competitive market. Particularly in countries with a longer history of microfinance—such as Bolivia or Peru—or in less populous countries where the potential number of clients is limited—such as Armenia or Bosnia—microfinance markets are reaching the saturation point. Given that many MFIs target similar clientele, share similar missions, offer financial products that vary only so much, and serve markets that allow only so many to operate, achieving scale and long-term sustainability can pose a huge challenge.

This was exactly the situation in which Micro-F and Kamurj, two microfinance operations run respectively by Save the Children (SC) and Catholic Relief Services (CRS) in Armenia, found themselves in 1999. In a country where economic stagnation, a dwindling population of roughly two million people, and a constant influx of aid monies continued to shape the development landscape, there were more than 15 microfinance programs operating at various levels in various geographic areas. SC and CRS were among the first organizations to begin micro-lending activities in Armenia. As more and more players entered the market and competed for funding and geographic turf, Micro-F and Kamurj risked losing the substantial investment they had made to date.

Both organizations ultimately had the same goals. Rather than going head-to-head, SC and CRS decided that the best response to the increasing competition they faced in Armenia's microfinance sector was to put their two heads together. In September 2000, SC and CRS officially merged microfinance operations into one local MFI, now known as the Kamurj Microenterprise Development Fund (MDF Kamurj). Combining the technical, financial, and human resources of both organizations, SC and CRS determined that a

merger was the best possible means of ensuring their clients' continued access to affordable financial services.

Armenia is not alone. Increasingly around the world, organizations in the microfinance sector are turning to mergers or other forms of consolidation in order to reap the potential benefits of cost savings, efficiency, access to markets, and ability to achieve scale and self-sufficiency. Microfinance organizations in the Philippines, Bolivia, Mongolia, Bosnia, and several other countries where microfinance mergers have recently taken place have shared their ideas and experiences, which are presented as examples throughout the book.

Short case studies of twelve of these merger experiences are collected in a companion resource, *Mergers in Microfinance: Twelve Case Studies* (Elissa McCarter, Editor, Baltimore: Catholic Relief Services, 2002), which is available electronically through the CRS Microfinance Unit, [mu@catholicrelief.org](mailto:mu@catholicrelief.org).

## **About This Book**

The purpose of this book is to provide an in-depth look at the merger process in Armenia in order to examine the pros and cons, explore the lessons learned, and articulate some guidelines for other MFIs that might be contemplating a merger or similar strategic move in the future. As a former manager of CRS's Kamurj Microfinance Program and someone who was intimately involved in the details of the merger process from start to finish, I address these issues principally from a practitioner's perspective. However, donors, scholars, and other interested parties within the microfinance community may find the book useful as well.

The term "merger" as it is used in this book refers to the legal act of combining two or more separate entities into one entity with a single governing body. In addition to mergers, there are several other options that MFIs can choose, including affiliation, alliance, or some other type of formal collaboration that falls short of a legal merger with, or legal acquisition of, another organization. (See Chapter 6 for details.) Moreover, merger goals and processes can vary depending on the legal status of the institutions involved: the

merging parties can be two nonprofit MFIs, two formal financial institutions, or a combination involving these and/or some other type of institution.

However it is defined, the process of integrating operations involves two sets of human resources learning to live and work together very closely—building trust, making compromises, and blending cultures, people, and systems. Whether your organization is contemplating a complete, legal merger or another form of collaboration, the ideas presented in this book should apply.

## **How to Find What You Need**

This book is divided into ten chapters that outline the merger process and discuss the lessons learned, from the initial negotiation phase to the post-merger integration phase.

### Chapter 1 **The M&A Phenomenon: Should MFIs Follow Suit?**

This chapter provides a general overview of mergers and acquisitions, with particular focus on the rise in bank mergers and the increase in nonprofit mergers, especially in the United States; and a summary of the types of mergers that have already become established in the microfinance industry around the world. The chapter concludes with a discussion of the dangers of mergers, reasons that mergers have failed, and the implications for those considering microfinance mergers in the future.

### Chapter 2 **Setting the Stage: The Armenia Context**

This chapter provides a backdrop for the merger in Armenia, presenting the historical background to the merger and offering operational descriptions of Save the Children, Catholic Relief Services, and two microfinance programs they launched in Armenia: Micro-F and Kamurj.

### Chapter 3 **Merger Phase I: Deciding to Merge**

This chapter is the first of several that outline the merger process, step by step, based on the experience in Armenia. Chapter 3 focuses on the factors to consider when deciding whether to merge—including the missions of the organizations involved, the economic conditions

and general operating environments in which they work, the available alternatives, and the costs and budgetary implications of a merger. The chapter details how to choose a merger partner, and how to examine both parties' strengths and weaknesses in light of what a merger would yield.

#### Chapter 4    **Merger Phase II: Getting Acquainted and Building Trust**

This chapter analyzes the initial negotiations in the Armenia merger and the lessons learned during the process. It discusses how to make the first approach; the value of using an outsider or neutral third party during the negotiation phase; how to begin learning about the merging parties in both informal and formal due diligence investigations; the red flags or warning signs to look for; and the Letter of Intent as a first step to officially moving the merger forward.

#### Chapter 5    **Merger Phase III: Strategic and Transition Planning**

This chapter describes the planning process that took place in Armenia; discusses how to develop a strategic plan and what issues to address; and emphasizes the importance of delineating the roles and responsibilities of those who will be involved in the merger process (including possible outsiders) and ensuring the participation of staff through task force teams. It also discusses the issue of timing and offers suggestions regarding how much time to allow for each step of the merger process.

#### Chapter 6    **Legal Aspects of Microfinance Mergers**

This chapter does not provide legal advice; rather, it offers guidance on how to go about investigating the legal issues that will need to be addressed in the country in which the merger will take place. It defines different types of formal collaboration and discusses the pros and cons of each one. It also addresses the legal specifics of an actual merger transaction in microfinance: how to deal with portfolio and asset transfers, some particularities to address in legal documents, and how to find an appropriate lawyer to help in the process.

## Chapter 7 **Culture Clash: The Human Side**

This chapter focuses on exploring and grappling with the cultural identities of merging parties (with reference to the problems faced in the Armenia merger), how to conduct a cultural due diligence investigation to predict possible areas of conflict, and how to manage cultural change during post-merger integration. The chapter includes several illustrations of both successes and failures in managing cultural conflict.

## Chapter 8 **Merger Phase IV: Post-Merger Integration**

This chapter discusses what happens after the official merger transaction is completed and provides some guidelines based on lessons learned the hard way in Armenia. Knowing in advance how to prepare, how to plan (and re-plan), and how to manage the process effectively is crucial to the success of a merger; the chapter offers suggestions and provides examples from other experiences in the for-profit, nonprofit, and microfinance sectors.

## Chapter 9 **The Mechanics of Merging MFI Operations**

This chapter outlines the issues involved in integrating all aspects of merging MFIs' lending operations. It highlights the problems experienced in Armenia and describes how the actual integration process proceeded, from staffing and salary decisions to MIS and internal controls. It also includes a short study of a fraud case that occurred in Armenia during post-merger integration.

## Chapter 10 **Summary and Conclusions**

This chapter summarizes lessons for future microfinance mergers that can be gleaned from the Armenia case and the other examples discussed in this book.

## Use of Symbols

The pages that follow are punctuated with symbols to highlight particular parts of the text. Here are the symbols and what they mean:



A helpful set of tips that usually follow a subject addressed in the preceding text.



A warning about WHAT NOT TO DO in order to avoid repeating the same mistakes.



An idea that arose after the Armenia merger and might be a good one for other merging parties to try.



The experience of another merger, used to support a particular point or lesson learned.



Direct quotes from the staff of MDF Kamurj who were involved in the Armenia merger process.

## Key Resources

This book draws on the work of various notable authors in the M&A field in the United States. While each country context may demand a special approach, four books stand out for their usefulness in drawing comparisons, their comprehensive scope, and their inclusion of practical tools such as checklists and templates for merger legal documents, due diligence procedures, and the like. These books are:

Jane Arsenault, *Forging NonProfit Alliances*. Washington: National Alliance for Nonprofit Management, and San Francisco: Jossey-Bass Publishers, Inc., 1998.

Timothy J. Galpin and Mark Herndon, *The Complete Guide to Mergers and Acquisitions: Process Tools to Support M&A Integration at Every Level*. San Francisco: Jossey-Bass Publishers, Inc., 2000.

Dan H. McCormick, *Nonprofit Mergers: The Power of Successful Partnerships*. Gaithersburg, MD: Aspen Publishers, Inc., 2001.

Thomas A. McLaughlin, *Nonprofit Mergers and Alliances: A Strategic Planning Guide*. New York: John Wiley and Sons, Inc., 1998.

There is a good deal of evidence to indicate that mergers (or some other form of consolidation in the microfinance sector) are the wave of the future for many countries, especially where microfinance providers are proliferating in limited markets. Indeed, this wave is already sweeping the sector—as the 14 other microfinance merger cases mentioned in this book illustrate. There is great value in building stronger institutions by linking up with competitors (as long as consolidation in the sector does not result in monopolies that would keep prices up and harm clients). Of course, problems will arise, and not all microfinance mergers, however well thought out, will succeed. But with careful consideration, the right foundation, strong leadership, and well-

managed integration, a merger can be a desirable strategic move toward building stronger institutions and ensuring permanent financial services for the poor.

Mergers are by nature a risky business. But so is the business of lending. If you find yourself in a situation similar to Micro-F or Kamurj and think a merger might be the right option for you, then hopefully this book will be of help. If there is anything that you think is missing or that you want more information about, please feel free to contact me at [emccarter1@aol.com](mailto:emccarter1@aol.com).



# Chapter One

## The M&A Phenomenon: Should MFIs Follow Suit?

*What we call mergers and alliances are really just a part of the innovation that the nonprofit sector must deliver over the next two or three decades.<sup>1</sup>*

–Thomas McLaughlin

The fierce competition that some MFIs face today, and the strategic positioning that competition requires, are nothing new in the business world. Increasingly, eat or be eaten is the rule of thumb for those who seek to expand their market share and beat out their competitors. The number of recent studies and publications on the merger & acquisition phenomenon indicates that mergers and acquisitions continue to define and reshape the markets in banking, health care, computer services, and many other sectors, including the nonprofit world, where consolidation is becoming ever more common. In 2000 alone, there were 9,566 mergers and acquisitions valued at over \$1.3 trillion, setting a new record for the ninth consecutive year.<sup>2</sup>

### **The Bank Merger Wave**

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In the United States, some 6,374 bank mergers occurred between 1980 and 1994.<sup>3</sup> A steady stream of around 500 mergers per year since 1993 has reduced the number of banks in the US and across Europe from over 13,000 to 9,000.<sup>4</sup> The forces driving this

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<sup>1</sup> Thomas A. McLaughlin, *Nonprofit Mergers and Alliances: A Strategic Planning Guide*, New York: John Wiley and Sons, Inc., 1998, xxii.

<sup>2</sup> *Mergerstat Review*, Chicago: W.T. Grimm & Co. 2001, 4-5. See also [Http://www.mergerstat.com](http://www.mergerstat.com).

<sup>3</sup> Stephen A. Rhoades, *Mergers and Acquisitions by Commercial Banks 1960-83*. Staff Study 142, Washington, DC Board of Governors of the Federal Reserve System, January 1985.

<sup>4</sup> Steven I. Davis, *Bank Mergers: Lessons for the Future*, London: MacMillan Press Ltd., 2000, 1.

transformation in the banking industry include fierce price competition as well as banks' efforts to increase efficiency and cost savings, size and scale, market share, geographic reach and product range, all while maintaining relative autonomy and fending off future takeovers.<sup>5</sup> The deregulation and intensifying competition that have resulted in overcapacity have fuelled the merger wave in the US banking sector. More recently, the trend toward mergers is affecting growing numbers of banks in Japan and Europe, where the merger trend appears likely to match that in the US before long.<sup>6</sup>

Several studies have attempted to evaluate the success or failure of the banking consolidation trend. While it is still too early to draw final conclusions, most agree that there is little evidence to indicate that bank mergers have reduced costs as a result of achieving scale, and some researchers express doubt that the anticipated gains will ever be realized.<sup>7</sup> Others, however, maintain that the mergers have created value by reducing bank risk, increasing diversification and market share, and improving outreach.<sup>8</sup> Despite these disagreements about its impact, the M&A trend continues to define and reshape the banking sector in the US and Europe, and is spreading eastward across the globe.

While the markets thus far affected are among the most developed in the world, it is easy to see this trend's relevance for developing-country markets and for the microfinance industry as a whole as it continues to mature. The Philippines is a case in point: In April 2000, the Central Bank of the Philippines amended its regulations for both banks and non-bank financial institutions to offer incentives to institutions that choose to merge. These incentives apply to both mergers, defined as the absorption of one or more corporations into another, and consolidation, defined as the union of two or more corporations into a new entity.<sup>9</sup>

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<sup>5</sup> McLaughlin, *Nonprofit Mergers and Alliances: A Strategic Planning Guide*, 10-11.

<sup>6</sup> Bernard Shull and Gerald A. Hanweck, *Bank Mergers in a Deregulated Environment*, Westport: Quorum Books, 2001, 204.

<sup>7</sup> See Davis, *Bank Mergers*; see also Shull and Hanweck, *Bank Mergers in a Deregulated Environment*; Gary A. Dymksi, *The Bank Merger Wave: The Economic Causes and Social Consequences of Financial Consolidation*, New York: M.E. Sharpe, 1999.

<sup>8</sup> See Charles W. Calomiris, and Jason Karceski, *Is the Bank Merger Wave of the 1990s Efficient? Lessons from Nine Case Studies*, Washington: AEI Press, 1998.

<sup>9</sup> See Bangko Sentral ng Pilipinas, Circular No. 237. *The Manual of Regulations for Banks and the Manual of Regulations for Non-Bank Financial Institutions*, pursuant

## Nonprofit Mergers

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*Every business person knows consolidation is a natural effect of time and learning. It's true in business and in nonprofits: You don't need two of everything*<sup>10</sup>

–Bruce Rohde, CEO of ConAgra Inc.

Beyond the banking industry, few businesses escape the inevitability of some form of collaboration with others as part of a strategic move to succeed in today's world. This holds true for nonprofit or non-governmental organizations (NGOs) as well. For example, American NGOs, particularly those in the food and health care sectors, are starting to catch on to the M&A idea, usually referring to it simply as consolidation. One example involves Second Harvest and Foodchain, two American charities that service food banks and soup kitchens and that staged one of largest charity mergers ever in 2000. Peter Goldberg, President and CEO of the new merged entity, explained: "Consolidation can help. Bigger organizations can better compete for government grants, they can more easily retain high-quality personnel and can more easily afford the technological improvements often needed to operate."<sup>11</sup>

Thomas McLaughlin, a leading expert in nonprofit management in the US, argues that NGOs are not immune to the restructuring that is taking place in banking, financial services, retailing, bookselling, and many other fields. In fact, he says, mergers among nonprofits are necessary, since a situation in which large numbers of NGOs focus all their efforts on fighting for limited funding from a few donors actually weakens the collective power of the entire field. In such a context, he argues, "Organizations that should be serving a mission must instead spend disproportionate

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to the Monetary Board Resolution No. 384 dated 10 March 2000, as amended by Monetary Board Resolution No. 573, 7 April 2000.

<sup>10</sup> As quoted in Jonathan Eig, "The Urge to Merge Hits Charities – As two major nonprofits wed to better tackle hunger, will the pot thicken?" *Wall Street Journal*, New York, April 18, 2000, B1.

<sup>11</sup> *Ibid.*

amounts of resources worrying about how they are going to fund it, manage it, and perpetuate it."<sup>12</sup>

Usually, businesses are motivated by financial or market pressure to increase shareholder value, whereas NGOs are driven more by their mission. McLaughlin argues that sharing a common mission actually makes it easier and more likely for NGOs to join forces through a merger or some other formal strategic alliance.

## **Should MFIs follow suit?**

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If the banking, business, and nonprofit sectors are any indication, it would seem logical for MFIs to consider some form of consolidation as the industry matures. In fact, this is already happening in some parts of the world—principally in Latin America, where microfinance is well established and MFIs operate in tight markets.

FONDESIF and GTZ make the case for microfinance mergers in a recently published technical paper on the formalization process in Bolivia:

It has also become clear that the microfinance market itself cannot accommodate an unlimited number of formal institutions, which need to be of a certain size in order to achieve economies of scale and work in different markets and regions under commercial arrangements. In Bolivia, the [Central Bank] is now very conservative and cautious about awarding new licenses because it believes there is currently a sufficient number of institutions in the microfinance sector. It feels that the existing institutions should consolidate themselves, diversify the services they offer, and expand or even merge with each other.<sup>13</sup>

The following table presents examples of mergers that have taken place to date, grouping them into four broad categories.

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<sup>12</sup> McLaughlin, *Nonprofit Mergers and Alliances: A Strategic Planning Guide*, xxii.

<sup>13</sup> Martina Wiedmaier-Pfister, Fabiana Pastor and Lucia Salinas, "The Formalization Process in the Bolivian Microfinance Sector and its Impact." Technical Bulletin No. 1 Bolivia, June 2001, edited by Martina Wiedmaier-Pfister (Rural Finance System Project) and Carlos Rodríguez Olivieri (Financial System Development and Productive Sector Support Fund/FONDESIF). This Bulletin is the first of a series of publications on issues of current interest published by the Rural Finance System Project (SFR FONDESIF-GTZ).

**Summary of Microfinance Mergers and  
Consolidations around the World**

<b>Merger of NGOs to Form New Institution</b>		
Corfinrural	Peru	Four cajas rurales (small rural banks) of Señor de Luren, Cajamarca, Cruz de Chalpón, and Los Libertadores de Ayacucho are in the early stages of a merger yet still under scrutiny of the Superintendency of Banks. In a separate case, two other cajas in Peru—Credinka/Cusco and Los Andes/Puno—are considering a merger.
FORA Fund	Russia	FORA Fund was formed in 2000 as a result of the consolidation of five Opportunity International partners working in Russia.
Thanakea Phum Cambodia (TPC)	Cambodia	CRS's Thanakea Phum Cambodia (TPC) microfinance program is in the process of merging its NGO partners to create one regulated microfinance institution. It expects to complete the process in early 2002.
Enlace	El Salvador	CRS's Enlace microfinance program in El Salvador purchased the portfolios of three local NGOs and transformed itself into a regulated entity.
Opportunity Microfinance Bank (OMB)	Philippines	Five microfinance NGOs merged operations to form a regulated microfinance bank, which opened its doors for business in August 2001. This merger was led by the Alliance of Philippine Partners in Enterprise Development (APPEND) and the Opportunity International Network.
MDF Kamurj	Armenia	Save the Children/US registered a local foundation into which both SC's and CRS's microfinance portfolios were transferred in September 2000. The merged entity is now known as the Kamurj Microenterprise Development Fund (MDF Kamurj).

### Consolidation of NGOs into an Existing Entity

ACCION USA/ Working Capital	Mass., USA	ACCION USA is in the process of absorbing Working Capital's portfolio in the Boston, Massachusetts area. Legal transfer took place in October 2001.
Asala	Palestine	Palestinian Women's Association (Asala) is a local microfinance NGO founded by Oxfam/Quebec. In order to add a group lending portfolio to its existing individual lending operations in Palestine, Asala absorbed CRS/West Bank/Gaza's microfinance program in February 2001.
World Bank-supported microcredit organizations	Bosnia and Herzegovina	During the period of June 1999-March 2000, five microcredit organizations that did not receive renewed funding from the World Bank's Local Initiatives Project merged with three organizations that did receive funding: NBR Modrica, Plavi Most, and Travnik Business Centre merged into Lok Micro Sarajevo; Lori Oraje merged into Sunrise Sarajevo; and Vrelo Mostar merged into World Vision/EKI.
ACCION International/ Calmeadow	Southern Africa	ACCION International absorbed all Calmeadow operations in Africa in March 2001.
XacBank	Mongolia	XAC (which translates as "Golden Fund for Development"), a licensed, non-bank financial institution, merged with Goviin Edhlel (GE), a small/medium enterprise (SME) non-bank financial institution in late 2001. The merger created a new micro/SME lending institution known as "XacBank" with a commercial banking license.

<b>Merger of NGO and Formal Financial Institutions</b>		
Financiera Confia	Nicaragua	In January 2000, the Mennonite Economic Development Associates (MEDA) Chispa microcredit program merged with Interfin, a licensed Nicaraguan financiera, to form Financiera Confia.
Genesis/ Bancasol	Guatemala	Genesis, ACCION International's affiliate NGO in Guatemala, merged with Bancasol, a local commercial bank.
<b>Merger of Formal Financial Institutions</b>		
Financiera El Comercio	Paraguay	Financiera El Comercio and Financiera Efisa, two regulated financial institutions, merged to form one institution offering micro, SME, and corporate business financial services.
<b>Failed Merger Attempts</b>		
PRODEM and FIE	Bolivia	In 2000, Fundacion para la Promoción y Desarrollo de la Microempresa (PRODEM), a Private Financial Fund (PFF), entered negotiations with Centro de Fomento a Iniciativas Económicas (FIE), a microfinance NGO, to explore the possibility of a merger. The plan was that the merged entity would initially maintain a PFF legal structure, and would later apply for a full commercial bank license. But FIE pulled out, fearing a takeover and loss of its mission and identity.
Eco Futuro	Bolivia	Eco Futuro was established as a separate entity owned by four NGOs that merged to form one PFF in May 1999. Yet these NGOs began to renege on their commitments two years later. Today, Eco Futuro is taking over loan and client portfolios from its member NGOs only in certain "commercially viable" areas.

Source: Elissa McCarter, *Mergers in Microfinance: Twelve Case Studies*, Baltimore: Catholic Relief Services, 2002.

Not all merger efforts have succeeded, such as the two failed attempts in Bolivia, but even successful mergers can be challenging. As USAID's Liza Valenzuela notes, "In all of these cases, the merger has been a difficult, taxing endeavor. Mergers are a natural part of any industry's consolidation process, but...we in the microfinance field need to keep in mind that they are costly and take a long time!"<sup>14</sup>

## The Dangers

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Although microfinance mergers may be the natural way forward as markets—and the sector overall—mature, it is important to remember the dangers inherent in mergers, and the potential for failure when mergers go awry. The examples above of failed merger attempts are just two of the many attempts worldwide that have failed. The statistics are daunting: estimates of the percentage of merger attempts that have failed to achieve the expected results range from 52 percent to over 75 percent. Why do so many good merger intentions turn sour?

The most commonly cited reasons for failure point to problems in post-merger integration rather than in merger strategy or planning. In other words, success appears to depend more on how the merger is implemented after the fact than on the process of for the merger itself.

### **Commonly cited reasons for merger failure:**

- conflicting corporate cultures
- overestimation of synergies
- inadequate due diligence
- slow/poor post-merger integration
- poor leadership or management

This is not to say that strategy is unimportant, but rather that those considering a merger should think carefully about their

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<sup>14</sup> Correspondence with Lisa Valenzuela, United States Agency for International Development (USAID), lvalenzuela@usaid.gov, on Devfinance Listserve, devfinance@lists.acs.ohio-state.edu, November 2001.

reasons for merging, research examples of mergers, and learn from the mistakes others have made.

One key point to keep in mind is that it is important that people at all levels of an organization support the merger. The success of the Armenia merger—this book's central case—was rooted in the fact that the organizations involved, and every person in them—from the international headquarters chief to the field officers—had established mutual trust, developed the commitment to make it happen, and mustered the stamina and perseverance to see it through to completion without losing sight of the ultimate purpose and focus: serving the clients. Despite the many difficulties encountered in the process of this merger, there is no one from either organization who wouldn't willingly go through it all again.

Although it may still be too early to pronounce the Armenia merger a success, the process itself and the positive results achieved to date indicate that all the pieces fit to make a merger the right choice. According to SC Economic Opportunities Unit Director Mark Edington, it was not so much a question of whether to merge, but how to do it. "It simply made sense commercially, financially, geographically. Without all these things, this kind of merger may not work in other countries. But we haven't ruled it out. In Armenia, we were and still are confident that it was a good move."<sup>15</sup>

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<sup>15</sup> Personal interview with Mark Edington, Save the Children, Economic Opportunities Director, Washington, DC, August 2001.



# Chapter Two

## Setting the Stage: The Armenia Context

### The Players

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#### **Save the Children/USA in Brief**

Save the Children Federation (SC) is a non-governmental multi-sectoral development and humanitarian aid organization working in more than 40 countries with an annual budget of \$150 million. SC was created in 1932 in New York City to respond to the needs of the children of coal miners in Appalachia. During World War II, SC expanded internationally to help displaced children and rebuild communities in eight European countries. SC concentrates on developing health, education and economic opportunities in order to achieve its mission: to make lasting, positive changes in the lives of children in need. SC's work maintains a focus on women and children and an emphasis on building local capacity.

Group Guaranteed Lending and Savings (GGLS) programs provide access to credit and savings for women living at or below the poverty line. SC's goal in microfinance is to build sustainable institutions that provide ongoing access to financial services for poor women microentrepreneurs. As of July 2001, SC's microfinance programs served 137,000 clients through local Microfinance Institutions in 17 countries and territories. SC's economic opportunities programs are funded by an array of government donors, private foundations, corporations, individuals, and trusts.<sup>16</sup>

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<sup>16</sup> [Http://www.savethechildren.org](http://www.savethechildren.org).

## **Catholic Relief Services (CRS) in Brief**

Catholic Relief Services is a multi-sectoral relief and development organization working in 87 countries and territories with an annual budget of \$400 million. It was founded in 1943 by the Catholic Bishops of the United States to assist the poor and disadvantaged outside the country. The fundamental principles that motivate CRS activities are expressed in Catholic Social Teaching, and focus on alleviating human suffering, promoting justice and development, and fostering charity. CRS responds to the needs of the poor throughout the world, regardless of their creed, race, or nationality.

As of April 2002, CRS's microfinance programs served more than 320,000 clients in 33 countries, working mostly through local partner organizations but with some direct retail and wholesale implementation from CRS country offices. CRS's microfinance programming has two major goals: 1) to significantly increase the scale of microfinance programs in terms of the number of clients served; and 2) to transform local programs into healthy, viable financial institutions. In its microfinance work, CRS seeks to work with people and organizations who share its vision of bringing the poor from the margins to the mainstream of financial services.<sup>17</sup>

## **The Dilemma**

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In May 1998, Save the Children's Armenia Field Office launched Micro-F as its first pilot microfinance program in Armenia, with only a small amount of seed capital. After a year and a half, Micro-F reached more than 1,500 clients who maintained excellent repayment rates.

But prospects for further growth looked dim. Renewal of established funding commitments and a possible new funding source were uncertain. The program had reached the point where it would have to cut group formation completely and cease all

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<sup>17</sup> [Http://www.catholicrelief.org](http://www.catholicrelief.org).

planned office purchases to cut costs as much as possible. Staff morale was already low, and even top staff members began to fear for their jobs.

To make matters worse, new players were already entering the market in the capital city of Yerevan, by far the best potential source of new clients. If the trend continued, Micro-F would lose its footing in the market, and all those hard-earned clients would move to another organization.

At around the same time, staff at the CRS/Armenia office began to question whether CRS's Kamurj Microfinance Program could achieve scale in such a small country. In 1998, CRS had established a small micro-lending pilot project that suffered high delinquency in its early months, forcing CRS to rethink its strategy for microfinance in Armenia and try to salvage its initial investment and donor commitments. Despite the shaky start, CRS relaunched the program under a new name, Kamurj, and established two branch offices with 500 active clients in less than six months. Nonetheless, the greatest potential source of clients, and the market that any MFI in Armenia would need to penetrate to achieve scale, was Yerevan. There were several players already in the market with the same target clientele, and Kamurj needed to define its competitive advantage.

CRS was also searching for the best option to localize its program, in accordance with its original exit strategy. The "spinoff" into a local microcredit organization, as called for in the strategy document, looked nice on paper; but achieving such a goal with a young organization whose staff still needed to mature professionally, and without having identified a competent local manager to take over, was another matter altogether. CRS needed to find a "champion" to assume leadership of the organization.

## The History of Micro-F

Micro-enterprise Development Fund (Micro-F) was established in May 1998 as a program of Save the Children/Armenia. With initial seed capital from Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), SC established the first Micro-F office in Sisian, a rural town in southeastern Armenia. A few months later, the Soros Foundation (OSI) provided seed capital to start a second lending operation in the capital city of Yerevan. From its inception, based on lessons learned in other countries, SC treated the microfinance program as a separate institution, maintaining separate offices and bank accounts. With strong leadership and well-trained staff, by December 1999 Micro-F had reached 1,541 active clients with \$137,550 in loans outstanding and a delinquency rate of 0.75 percent.

Despite the solid base it had built and its hopes to launch a full-scale microfinance institution, Micro-F ran into serious funding problems when its two original donors were unable to renew their commitments. While GTZ extended its grant for the Sisian branch until May 2000, OSI ceased funding for the Yerevan operation. Although SC had been short-listed for a grant from USAID, this funding was still uncertain, and in any case would not be available until October 2000. This resulted in a serious shortfall of funds and placed the Armenia staff in the uncomfortable position of waiting to see whether the program could continue to exist. Shortly thereafter, SC entered into negotiations with CRS over bridge funding to support Micro-F operations and to explore the possibility of a formal merger. From December 1999 to May 2000, Micro-F had to suspend the formation of new client groups in order to use its remaining capital to cover operational costs until SC finally secured the bridge funding from CRS.

In April 2000, Micro-F was officially registered as a nonprofit Fund (or foundation) under Armenian law in preparation for the transfer of assets from both SC and CRS programs, which took place five months later, in September 2000.

## The History of Kamurj

In July 1998, with seed capital from the Netherlands-based Consortium on Relief and Development Aid (CORDAID), CRS's Caucasus Program started a small pilot project working through a local business center to extend credit to microentrepreneurs in Armenia. Within six months, the business center had reached approximately 300 clients in the northern Armenian city of Vanadzor through a village banking methodology. Just four months after it made its first loan, however, the project began to suffer high delinquency rates, with repayment falling from 94 percent in December 1998 to 63 percent by February 1999. After re-evaluating the project, CRS determined that the poor results were caused by a combination of insufficient training of local managers and staff, concentration on products not suitable for a region facing significant economic decline, and a partner organization that really did not share CRS's vision of specializing in financial services, nor its focus on serving the poorer of Armenia's economically active people.

After considerable debate, CRS applied the lessons learned from this first experience and decided to take over lending operations from the business center. In May 1999, CRS developed a five-year strategy to provide financial services to poor women microentrepreneurs, initially through direct retail and later through the spinoff registration of a local microfinance institution. With its revised methodology and new marketing name, Kamurj (meaning "bridge" in Armenian), CRS aimed to provide a permanent financial bridge to a more secure future for Armenian families.

In October 1999, Kamurj disbursed its first loans from the Vanadzor branch; in December 1999, it set up a second branch in Gyumri. In less than six months, Kamurj had reached nearly 500 clients and had increased on-time repayment to 95 percent. Having firmly established a market niche in the second and third largest cities in Armenia, Kamurj still needed access to the capital—the country's largest market—to assure stability and future growth.

It was at this point that CRS and SC began to explore the possibility of a merger. By the time Kamurj transferred its operations into the new Fund, it had regained the ground that Micro-F had lost during the period of funding constraints, and had built up a portfolio—comparable in size to that of Micro-F—of 1,483 active clients.

## **The Seed of an Idea**

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The idea of a merger had first been raised in May 1999, when CRS was revising its market strategy for the launch of Kamurj. SC and CRS microfinance programs had established a good working relationship through the Armenia Microfinance Forum, an informal monthly gathering of microfinance practitioners. After visiting the SC Yerevan office and seeing the young dynamic staff and the results it had achieved to date, CRS concluded that this was exactly the type of operation it needed to replicate. Discussions with an independent consultant invited to Armenia to help CRS begin implementing its new strategy helped crystallize this vision of a merger with SC.

But this vision was not initially accepted. CRS regional staff resisted the idea of formal collaboration with SC, perceiving it as giving up. CRS had already made a significant investment in microfinance in Armenia, and considered microfinance to be one of its core competency sectors in the region.

Consequently, CRS launched its program independently, although it still maintained an informal, friendly relationship with the Micro-F staff. Then, in November 1999, the Micro-F director disclosed the extent of Micro-F's funding crisis and the idea of a merger re-emerged in full force.

## **"Try, Try Again"**

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By this time, several aspects of the situation had shifted to make a full merger of SC and CRS operations a real possibility. First, there was a turnover in CRS staff, and the new staff were able to take a fresh look at the proposition. Second, within a short

period of time, CRS's Kamurj program had managed to build a strong portfolio, an effective team of trained staff, and a solid presence in desirable markets, which made Kamurj more attractive to SC. Third, SC management was under pressure to locate short-term funding to support its operations until the probable USAID grant was secured. This potentially large grant constituted a major incentive for CRS to pursue the merger. Finally, increasing competition, a limited market, and the pressing need for geographic expansion and outreach to achieve scale pushed SC and CRS even closer to having to compete head-to-head in the marketplace. For all of these reasons, when the merger idea was broached a second time, both SC and CRS were open to discussing it.

**TIPS** 

**Build informal relationships** before you ever say the word merger. SC and CRS staff at the technical and field levels had established strong relationships long before the merger idea arose. These relationships made the first approach much easier, as SC and CRS were already comfortable with one another. When asked about the final clincher that made the deal work, consultant Susan Gibson replied, "It's the people involved in the deal that matter. It worked because there was a level of trust already established. It's all about who you know and who you trust, because at some point you will have to relinquish the lead and compromise."<sup>18</sup>

**Think the unthinkable.** The merger in Armenia would never have come about had we not stretched our imaginations and asked "What if?"

**Don't take no for an answer** the first time. (Or even the second.) If CRS/Armenia country staff had not pushed a second time to gain CRS regional support for the idea of a merger with SC, then it would have remained simply that—an idea. ■

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<sup>18</sup> Telephone interview with Susan Gibson, independent microfinance consultant, September 2001.

 **EXPERIENCE****Informal Relationships**

Several other microfinance merger cases, including those involving Opportunity Microfinance Bank in the Philippines, Asala in Palestine, and ACCION USA, also point to the importance of establishing informal relationships among the people involved and building trust long before the actual merger date. For example, according to ACCION USA CEO Bill Burrus, the possibility of a merger with Working Capital in Boston was explored a full three years before the actual merger took place. Although they initially decided against a merger, the two organizations maintained ongoing contact and continued to cooperate informally through shared trainings and technical assistance. In early 2001, when ACCION reconsidered Working Capital as a potential merger partner, these three years of informal collaboration made the discussions easier. Moreover, Working Capital's new CEO had introduced changes related to both the organization's methodology and its financial health. When presented with the merger idea, he was open to exploring the idea in earnest.<sup>19</sup> ■

Thus, three critical elements were in place before the merger deal was made, and without which it would have failed: *mutual need*, *mutual trust*, and *people committed to making it happen*. Although some of the *why* and *how* of the Armenia merger was context-specific, many aspects of the process apply to mergers in general and thus provide important lessons to other practitioners who might build upon the Armenia experience as a model for the future. What follows in the next chapters is a step-by-step explanation of the merger in Armenia, and the general guidelines that emerged from that process.

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<sup>19</sup> Telephone interview with Bill Burrus, ACCION USA Chief Executive Officer, September 2001.

# Chapter Three

## Merger Phase I: Deciding to Merge

### Does It Fit?

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#### Mission first

Once the idea of a merger between SC's Micro-F and CRS's Kamurj was on the table, the first questions that each party asked itself about the other was, "Do they share our mission? Do we have the same purpose and goals?" Mission is one of the things that set nonprofit organizations apart from other institutions, defining them as socially-oriented actors whose bottom line is not shareholder value but working for a social cause. MFIs, even those that operate as for-profit financial institutions, are usually created for and driven equally by this social mission; they have a "double bottom line" even when shareholders are involved.

When SC and CRS laid their respective missions for microfinance in Armenia side by side, they found they were remarkably similar:

#### **Micro-F / Save the Children**

##### ***Mission***

*To increase economic opportunities and foster self-help, mutual support and entrepreneurial activities of poor families in Armenia to achieve social and economic security through the creation of a viable nation-wide institution that provides long-term microfinance services and technical assistance to women so they can expand their businesses and become permanent economic structures.*

## Kamurj / Catholic Relief Services

### **Mission**

*To address economic injustice and assist Armenians in the difficult transition from a central to a market-based economy, Kamurj will provide economically active microentrepreneurs (100% women) with access to affordable credit through the creation of a local, sustainable microfinance institution.*

These mission statements communicated the same idea: Create a local microfinance institution that will lend to women microentrepreneurs and improve family incomes in Armenia. One of the first exercises that the two sets of staff did together was to articulate a united mission statement that captured their shared purpose - and that was easy to remember and say in one breath. This exercise provided an opportunity to rethink, reconfirm, and recommit to the true purpose as a new merged entity. The new version (loosely translated from Armenian) read as follows:

### **Merged Mission:**

*We provide long-term financial services to women micro-entrepreneurs to improve their businesses' and families' well-being.*

## **The Deciding Factor**

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Although sharing mission and goals at the program level was important, even more important to staff at both organizations was a shared understanding of why their organizations were created, whom they were there to serve, and how they should serve them. Each agency is unique, with its separate history and cultural ties, but SC's and CRS's principles in microfinance were highly compatible:

- **Focus on the poor and the vulnerable, particularly women and children**

CRS's mission is to serve the poor and the vulnerable, regardless of race, religion or nationality. SC was created to improve the lives of vulnerable children. Both recognize that the poorest and most vulnerable around the world are disproportionately women and children, and both organizations' microfinance programs therefore shared a common target clientele: economically active women.

- **Focus on microfinance as a poverty alleviation strategy**

Both CRS's and SC's goals in microfinance are to focus on poorer economically active women most in need of financial services. This usually takes the form of group rather than individual lending to avoid excluding those who cannot afford collateral.

- **Focus on microfinance as a business**

CRS's and SC's philosophy in microfinance is to create new local organizations and/or build capacity of existing organizations that will become permanent providers of financial services. Whereas CRS tends to work through existing local partners to build capacity (Armenia being an exception to the rule, since CRS opted for direct retail), SC has a history of spinoff institutions that begin as credit programs from an SC field office. Despite the different approaches, both agencies emphasize efficiency, client responsiveness and achieving operational and financial sustainability to ensure a successful microfinance business.



## **EXPERIENCE**

### **When Mission Matters Most:**

#### **An Example from CRECER / Freedom from Hunger**

Crédito con Educación Rural (CRECER) was formed in 1994 in Bolivia as a program of Freedom from Hunger, an international NGO headquartered in the US. Before the inception of CRECER, Freedom from Hunger had been

implementing *Credit with Education*, village banking integrated with health/nutrition education, on a small-scale, pilot basis in Bolivia since 1990. CRECER was created to further expand the program in Bolivia by enhancing local leadership and management. In 1995, Freedom from Hunger received a five-year, \$2 million grant from USAID's Microenterprise Development Implementation Grant Program to build CRECER's institutional capacity for delivering cost-effective *Credit with Education* services, and to assist CRECER in becoming financially self-sufficient. As of December 1999, CRECER had expanded its services to reach nearly 20,000 women in rural areas of Bolivia, with the smallest average loan size (\$165) of any major microfinance institution operating in Bolivia and reaching the poorest and hardest-to-serve market segment.

To achieve long-term financial self-sufficiency, CRECER needed to move beyond the program level to become a full-fledged institution. It explored several institutional options, including a merger with a finance company, BancoSol, and with NGOs considering transformation to formal financial institutions. A key disincentive for the merger option was the lack of shared vision between CRECER and potential merger partners regarding reaching the very poor in remote rural areas. In large part, this was because CRECER had not yet demonstrated operational self-sufficiency; potential partners were skeptical of CRECER's potential to become financially viable, and of its emphasis on integrating education with credit services.<sup>20</sup>

After weighing other options, such as transforming itself into a credit union or a Private Financial Fund (PFF),<sup>21</sup> CRECER ultimately chose to establish itself as an independent NGO. This institutional type best enabled it to achieve its mission and goals. CRECER had its priorities straight: legal structure did not define its mission, but rather followed from it. ■

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<sup>20</sup> Kathleen Stack, *Institutional Options: Crédito con Educación Rural (CRECER) in Bolivia. From INGO to Local NGO*, Davis, CA: Freedom From Hunger, June 2000.

<sup>21</sup> A PFF is a type of commercial finance company established in Bolivia that is allowed to provide money transfers, offer foreign exchanges services, receive savings and time deposits, and contract obligations with second-tier institutions. It is restricted from offering checking accounts, foreign trade operations, equity investments, and security placements.

## TIPS

**At the end of the day, what keeps negotiations on track is constant focus on mission and confidence that mission is shared.** If CRS and SC staff had not maintained a focus on the ultimate reason for the merger—to help low-income women in Armenia create better lives for themselves and their families—then issues over territory, control and credit might have derailed the whole process.

For SC staff, the deciding factor was comfort with their counterparts in the Microfinance Unit at CRS headquarters, and the fact that they shared common philosophies about microfinance.<sup>22</sup> Likewise, for CRS, the ultimate decision to entrust its portfolio to SC—which, as legal founder of the new merged entity, would have final authority—was made possible by its confidence that SC shared its mission and would make the right strategic decisions.<sup>23</sup> ■

## What's the Alternative?

Due to the conditions in Armenia, both SC and CRS would have found it very difficult to continue to operate independently. Despite the risks, both sides agreed that a merger was the best course to pursue.

Armenia hosts a proliferation of lending programs, subsidized by international aid, that serve both the SME market (with loans in the range of \$1,000-\$50,000) and micro-level clients (with loans under \$1,000). In addition, although commercial banks in Armenia mostly trade in government securities, and there is less incentive for them to enter retail markets, a handful of banks with extensive branch offices extend loans as small as \$100 to entrepreneurs who have the gold collateral to put forward. In a small country with a population of less than two million, almost half of which is concentrated in the capital city, lenders soon find themselves faced with problems of overlap and market saturation.

<sup>22</sup> Personal interview with Mark Edington, SC Economic Opportunities Director, Washington, DC, August 2001.

<sup>23</sup> Correspondence with Kim Wilson, CRS Regional Senior Technical Advisor for Microfinance in Eastern India and former Director of the CRS Microfinance Unit, Baltimore, MD, August 2001.

## TIPS

**When considering a merger, consider the alternatives as well.** Armenia's tight operating environment made it next to impossible for CRS and SC to go it alone, and there was enough familiarity and trust between the organizations to make merging the right choice. But merging is just one way to team up with a competitor. Other options for collaborating, short of a full-fledged merger, are discussed in Chapter 9.

### **Be aware of reasons NOT to merge.**

- 1) When escaping a threat, a company on the defensive often imports its problems into the merger. Likewise, a company eager to find a partner may overlook that partner's liabilities.<sup>24</sup>
- 2) If an organization hits an internal crisis, it may lack the focus required to make the merger work. Whenever possible, MFIs should avoid mergers in times of delinquency crises, economic instability or other internal crises. ■

## **What Do We Lack? What Do They Have?**

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After determining that their missions were compatible, and their other options were few or none, SC and CRS took a closer look at exactly what they each lacked and what the other would bring to the table in the event of a merger. This SWOT (Strengths, Weaknesses, Opportunities, Threats) exercise helped both parties determine whether merging was a viable option (see next page).

When CRS and SC examined their respective weaknesses and strengths, they decided that a merger made not only philosophical sense but also commercial sense for building a strong microfinance institution in Armenia that would be able to achieve each agency's mission and goals:

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<sup>24</sup> An example from the banking industry involves the German bank Bayerische Vereinsbank, which sought a merger with Hypobank to avoid a potential takeover by Deutsche Bank. It took more than two years to discover the full problems with Hypobank's balance sheet. See "How Mergers Go Wrong," *The Economist*, July 22, 2000.

What CRS lacked:	What SC had:
<ul style="list-style-type: none"> <li>- Local leadership</li> <li>- Localization strategy</li> <li>- Access to Yerevan (the largest market, crucial to achieving scale)</li> <li>- Large, long-term funding commitment</li> </ul>	<ul style="list-style-type: none"> <li>+ Strong local manager and excellent staff</li> <li>+ Incorporated local institution (to be completed in April 2000)</li> <li>+ Geographic coverage (Central, South)</li> <li>+ Established branch operations and growing client base</li> <li>+ Potential for large grant from USAID</li> <li>+ Regional network of MFIs; specifically, a presence in the Caucasus</li> </ul>

What SC lacked:	What CRS had:
<ul style="list-style-type: none"> <li>- Short-term funding to bridge the gap</li> <li>- Access to earthquake region (includes second- and third-largest markets)</li> </ul>	<ul style="list-style-type: none"> <li>+ Private funding sources available</li> <li>+ Good donor contacts</li> <li>+ Geographic coverage (North/earthquake zone)</li> <li>+ Established branch operations, trained staff and growing client base</li> <li>+Global and regional network of technical assistance advisors and MFIs</li> </ul>

- **Financial stability.** Combining CRS's private funds and its donor contacts with SC's donor contacts increased the chances of securing future funding for the merged entity. In addition, SC was facing an urgent shortfall and needed CRS's private funds to bridge the gap until a long-term grant materialized.

- **National coverage.** SC and CRS each had an established presence in the market areas the other needed to enter. Merging would instantly convey to the merged entity both national coverage and a foothold in the three largest markets in Armenia, with greater potential to grow rapidly and "take the market" before other MFIs could firmly establish themselves.
- **The means to achieve scale and self-sufficiency.** The cost savings and greater funding potential expected to result from combining operations would enable the merged entity to reach a larger number of people, achieve scale sooner (a planned 10,000 clients in three years), and break even within two to three years.
- **Career paths for staff.** A larger merged entity would have an advantage over smaller operations in terms of offering staff members opportunities for learning and promotion, and attracting and retaining qualified staff.
- **Combined technical resources.** Combining SC's regional network of affiliated MFIs in the Caucasus with CRS's well-established global and regional (Europe) network of microfinance advisors and MFI partners would double the technical resources available to the merged entity.
- **Expected operating efficiencies.** Consolidating operations would decrease overhead and administrative costs in the long term, although short-term start-up costs might increase.
- **Lasting resources for the entrepreneurial poor.** Perhaps the most important factor for both agencies was that, if the merger achieved the outcomes expected, the merged entity would ensure the long-term availability of important financial services.

All of these reasons added up to a convincing argument for top CRS and SC management to consider the merger idea seriously. Although negotiations took a great deal of time and effort (see Chapter 4), ultimately a clients-first focus helped push the merger through and avoid the common pitfalls of pettiness and turf issues.



### **EXPERIENCE**

#### **Transfer during good periods, not bad ones.**

In early 2001, Asala, a local Palestinian businesswomen's association, absorbed CRS's microfinance program in Gaza. Given the environment in Palestine, Asala and CRS had few options other than to conduct the transfer during the *Intifada*, and the resulting lower portfolio quality and restrictions on movement exaggerated the difficulties of the transfer. Asala staff members acquired the program during a difficult period when repayment and client discipline were low. The restrictions on movement imposed during the *Intifada* prevented managers from making frequent visits to branches in order to solve problems as soon as they arose.

However, organizations operating in troubled environments do not always have the luxury of waiting. Asala's case is proof that a merger is possible even under the most difficult conditions. Overall program performance held steady and Asala continues to operate despite the extreme escalation of violence and dire economic conditions.<sup>25</sup> ■

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<sup>25</sup> Correspondence with Reem Abboushi, Executive Director, Asala, [asala@palnet.com](mailto:asala@palnet.com), and Tim Nourse, CRS Regional Technical Advisor and former CRS/JWBG Microfinance Program Manager, [timnourse@aol.com](mailto:timnourse@aol.com).

## TIPS

**How do I choose a merging partner?** SC and CRS each had the advantage of choosing a partner that was more or less familiar, shared their mission, and possessed complementary strengths. This case in particular, and the nonprofit literature in general,<sup>26</sup> point to several key characteristics to look for in a merging partner.

### Checklist for Choosing a Merger Partner

- Common mission
- Good repayment history
- Geographic compatibility/complementarity
- Compatibility of services
- Compatibility of culture (see Chapter 7)
- Intangible assets (such as political or donor connections)
- Tangible assets (such as a local champion, prized board member, trained staff, real estate, branch establishment, cash) ■

## What's the Cost?

Many well-intentioned and optimistic plans for achieving cost savings and operational efficiencies leave people sorely disappointed when results take longer than expected and the short-term cost is higher than anticipated. The reality is that mergers can be expensive. MFIs should not underestimate the immediate, up-front cost of the merger process itself—in terms of both dollars and time, or the "sweat equity" of staff involved.

The Armenia merger incurred not only legal counsel fees, representation and publicity fees, but also the up-front operating cost of essentially launching a brand new organization that needed bigger office space, more layers of support staff, and

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<sup>26</sup> For more about why nonprofits merge and how to pick a partner, see: Jane Arsenault, *Forging NonProfit Alliance*, Washington: National Alliance for Nonprofit Management, and San Francisco: Jossey-Bass Inc. Publishers, 1998; see also McLaughlin, *Nonprofit Mergers and Alliances*.

outside assistance to set its operations in motion. The following list includes some costs to consider. Depending on the circumstances, there may be other costs as well.

### **Costs Associated with Mergers**

#### **Merger Process Costs**

- Consulting fees and third-party facilitator
- Legal advice
- Up-front monies for severance pay (for transferred and terminated staff)
- Financial audit (if required for due diligence)
- Travel and related costs (for meetings, field visits, due diligence review, etc.)
- Translation costs (if applicable, for legal documents, publicity, etc.)
- Publicity (public announcements on TV, news, radio; other PR)
- Social events and parties (see Chapter 7)
- Sweat equity/staff time

#### **Merged Entity Operational Costs**

- Publicity (new logo design, advertisements, new brochures, client passbooks, other materials)
- Investments (leases for bigger office space, furniture, capital equipment as needed)
- New staff hires to fill support and other positions as needed
- Other start-up costs
- Sweat equity/staff time to implement the post-merger plan

 **EXPERIENCE****Contingency Funds: Budget for the Unknown Factors**

*What the practitioners say:*

Stacie Schrader, Russia Country Director of Opportunity International and Chair of the FORA Fund, advises those considering mergers to expect to increase their budgets during the merger process, even if budget reduction is one of the ultimate goals of the merger.<sup>27</sup>

Likewise, Gonzalo Puente, former General Manager of Eco Futuro in Bolivia, identifies cost as a sticking point in the Eco Futuro merger. The process of creating Eco Futuro took three years, and the cost incurred at the pre-operational stage alone, simply to organize and incorporate Eco Futuro as a Private Financial Fund (PFF), amounted to \$500,000. "According to a detailed study carried out by external consultants, if we include additional expenses which the founding NGOs absorbed, which permitted the PFF to work in their facilities while the company became incorporated, this amount is closer to \$700,000. The amount was paid almost totally by the founding shareholders according to their shares."<sup>28</sup> This unexpected burden created additional tension during the Eco Futuro merger process. ■

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<sup>27</sup> Correspondence with Stacie Schrader, Opportunity International Russia, Country Director and Chair of FORA Fund, stacieschrader@cs.com, November 2001.

<sup>28</sup> Gonzalo Puente, "A Different Experience in Bolivian Microfinance: Fondo Financiero Privado Eco Futuro S.A." Presented at Conference on Microfinance sponsored by BNDES and IADB, Rio de Janeiro, Brazil, May 2000. (Translation arranged by CRS, Peru.)

# Chapter Four

## Merger Phase II: Getting Acquainted and Building Trust

### The First Approach

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Suggesting a merger can be tricky: how the suggestion is made, and by whom, can have a big impact on how it is received. In the Armenia merger, an outside consultant in the role of impartial broker did more than anything break the ice, make both parties feel comfortable, and smooth over any tensions. Both SC and CRS technical staff at headquarters and on the ground were comfortable with this consultant and trusted her judgment. This carried more weight than anything else during the negotiation phase.

In choosing an outside broker, it is important to find someone who will get to know the key players beforehand, learn their agendas, and be able to anticipate resistance. They should be able to persuade skeptical staff from both parties of the importance of the merger, but in a way that preserves each organization's sense of autonomy. The broker for the Armenia merger expressed it this way:

Meeting with each side separately—*in person*—before any negotiations began gave the perception that I was the "middleman," a kind of "benevolent spy" on their side. This gave each side additional assurance that they were making the right choice.<sup>29</sup>

With both sides aware that SC needed money, the broker's role was to couch the merger in terms of its being mutually beneficial to both parties, and then to elicit specific information

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<sup>29</sup> Telephone interview with Susan Gibson, independent microfinance consultant, September 2001.

regarding the extent of SC's financial need, and whether CRS was willing to put that sum forward. Both organizations were already familiar with each other; once they trusted the advice they were receiving from the broker—that it was both sound and impartial—the path was cleared for the merger to go forward.

### TIPS

**Having an outside "honest broker" make the first approach and facilitate the deal can be crucial to success.** Finding the right person, however, may not be easy. Some options include: a shared and trusted consultant; a board member who knows a member of the other party's board; an auditor; an attorney (these will be much more formal unless they are shared, friendly contacts); a mutually trusted colleague; or another known, professional, mutually respected, paid intermediary.

**The broker's first job should be to make sure everyone on each side understands why the merger is being proposed—before negotiations begin.** There is no point in going into negotiations unless everyone understands what's at stake and what there is to be gained. If the broker discovers that this is not the case, more groundwork needs to be done. Unless internal divisions and disunity are worked out ahead of time, the process will stall before it ever gets started.

**The mutual needs the merger is intended to meet are primary.** The broker should understand these needs, communicate them to each side, and keep everyone focused on them. The consultant for the Armenia merger was able to gain the support she needed from staff at all levels of each organization because she kept bringing the discussion back to mutual needs and what was most attractive for each side. SC needed funding—fast. CRS needed an exit strategy that wouldn't sacrifice its mission. By focusing on these two key selling points, the broker helped convince top decision makers that the merger would make a good fit. ■

## Laying Groundwork for the "Human Side"

Once the seed was planted and both sides appeared to support the merger idea, it was important to continue laying the

groundwork for the human side. This meant talking to board members, managers, and field staff to anticipate potential areas of resistance and avoid surprises later. It also meant examining cultural differences within each organization to identify and anticipate potential clashes. One of the lessons learned by SC and CRS during the merger process was that the distinct culture of each agency had a lot to do with how the process unfolded. Paying more attention to these in the beginning might have enabled the organizations to avoid some of the frustrations that emerged along the way.

In fact, some seasoned merger analysts argue that every merger should add cultural due diligence to the checklist, meaning that the organizations involved should investigate cultural differences as thoroughly as financial position and strategic fit.<sup>30</sup> (Culture clash and how to manage it, including how to conduct a cultural due diligence, is addressed in Chapter 7.)

## **Board Support**

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Support for the merger at the local board level is key: without board approval, the merger cannot proceed. If there is resistance among board members, it needs to be addressed early on. And even when resistance is not a problem, the idea still needs to be sold to the board.

Although the Armenia merger did not face the issue of local board resistance, since neither program was sufficiently developed to have established a functioning local board, both SC and CRS did have to sell the idea to the executive management at both agencies' headquarters. For SC, this is a relatively straightforward process: if the technical unit director of a program department is in favor of a change, the vice president of programming for SC generally approves it, and the decision usually goes forward.

For CRS, however, decisions take place through consensus building among relevant actors within the agency. This practice is

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<sup>30</sup> For more information about cultural due diligence, see: Mitchel Lee Marks, "Adding Cultural Fit to your Diligence Checklist," *Mergers & Acquisitions*, Nov/Dec 1999. See also Kenneth W. Smith, "A Brand-new Culture for the Merged Firm," *Mergers & Acquisitions*, May/June 2000.

rooted in the fact that CRS strives to incorporate the principles of Catholic Social Teaching and maintains a focus on justice in every aspect of its work—from the way it designs programs to the kind of relationships it establishes externally with its partners and internally among CRS staff. For final approval of the merger, CRS needed to build consensus along field, country, regional, technical, and executive lines. This entailed time-consuming and repeated presentations and small group discussions, and frequent correspondence at various levels to bring everyone on board. Because each stakeholder group had different levels of understanding of the Armenian context and of microfinance, it was necessary to find the right approach, try to anticipate questions and concerns, and clearly justify the reasons to go forward.

These divergent decision making processes revealed a pronounced difference in SC's and CRS's organizational cultures. What ultimately convinced both SC and CRS senior executives to move forward was their *confidence in the people involved*. Without confidence in the leadership of those who were advocating the merger, senior management, who recognized their distance from the field and their limited knowledge of the details, trusted their country- and technical-level staff to make the right decisions.

## **Management Support**

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Managers' support for a merger is also critical to success. In the Armenia merger, both program managers saw the value in what a merger would bring to our respective programs, and understood the likely consequences if the merger were to fail. Moreover, we were spared the tensions many merging partners experience over who is to lead the new entity. It was clear from the beginning that the local SC manager was the natural choice to take the lead: he had the most experience and, being Armenian, was committed for the long term. Other merger efforts have had a more difficult time resolving this issue. (For tips on choosing an Executive Director, see Chapter 5.)



## **EXPERIENCE**

### **Hire Only One CEO**

Hiring two CEOs can blur the lines of responsibility; and if one person underperforms, the other is left holding the bag.

This was one of the key lessons learned during the Chispa-Interfin merger in Nicaragua. When the parties could not agree on the choice of a General Manager to run the merged Financiera Confia, they reached a compromise for a transition-period "management partnership" consisting of the former General Manager of Interfin and a former employee of the German consulting firm IPC. When the former Interfin General Manager did not show up for work for three days, a majority of the parties agreed he should be fired and replaced by the former Chispa Chief Financial Officer. In the subsequent months, the new General Manager and her staff worked day and night to document the adjustments required due to the poor quality of the Interfin portfolio and other balance sheet items. By August 2000, all former Interfin senior management had left the institution, the dual management arrangement was discontinued, and stock was issued to the new shareholders reflecting the new ownership structure. Finally, the official step had been taken in the formation of a transparent and efficient financial institution.<sup>31</sup> ■

## **Staff Support**

Ultimately, it is the staff of each organization who will have to implement the merger. Therefore, it is important to build staff support from the start. In Armenia, getting buy-in from staff took many months of encouragement, reassurance, and confidence-building. The key was to keep staff informed, reassure them about job security, and begin to bring people from both sides together, so that the unknown became more familiar.

To keep field-level staff on board, SC and CRS had to guarantee that no jobs would be cut and all current staff would be transferred to the merged entity (at the same or higher salary level)

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<sup>31</sup> Joyce Lehman, "CHISPA to CONFIA: A Transformation." Presented at the IV Inter-American Microenterprise Forum, Santo Domingo, Dominican Republic, November 14-16, 2001.

for at least a six-month probation period. These assurances had to be made on several occasions, but doing so helped alleviate much of the stress and anxiety of leaving the rich international "parent" for a poor Armenian one.

**“ STAFF  
QUOTES ”**

"My first reaction when I heard about the possibility of a merger was DO WE REALLY NEED IT?"

**–Lusine Simonyan,**

*Senior Loan Officer, Micro-F Yerevan Office*

## **Legal Restrictions**

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Every country has different rules and regulations, so it is important to investigate existing laws that might be an obstacle to merging, such as anti-trust laws, labor laws, or banking restrictions that might apply. (Chapter 6 discusses this topic in detail.)

## **Donor Support**

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In Armenia, the donors involved on both sides were supportive of the idea of a merger. There were no restrictions that prevented either SC or CRS from transferring assets purchased with donor funds into the merged entity, and any amendments needed or other legal specifications were relatively easy to accommodate. However, this is not always the case, and as a general principle it is important to research ahead of time any legal restrictions or philosophical objections that might make donors resist a merger. Some donors may see the move as restricting competition, or they may not be familiar with the merging partner. Donors usually also want to make sure they still receive some kind of recognition. Selling the merger to donors may entail additional preparation.

## TIPS

**How to counteract "board egos."** Thomas McLaughlin notes that board members may be resistant to a merger if they perceive it as a sign of failure or a threat to their sense of institutional identification or personal affiliation. To counteract this resistance, he suggests presenting the merger as a strategic option—for example, by conducting a mini-strategic planning process where the board lists the advantages and disadvantages of a merger with another organization. Through a guided discussion with management about how the positives can be achieved and how the negatives can be avoided or mitigated, the board can be made to feel confident about approving a merger.<sup>32</sup> ■

## Face-to-face negotiations

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Getting everyone together around the table was next to impossible, given that SC's and CRS's US headquarters were distant from each other and a long journey from Armenia. Although negotiations began with a teleconference in mid-January, it was almost two months before SC and CRS key players finally met in person. In March 2000, SC's Economic Opportunities Technical Specialist arrived in Armenia to meet with CRS and SC country directors as well as Micro-F and Kamurj managers to begin strategic planning. Meeting face to face made the merger a reality and dispelled each side's fears and anxieties about the other's true intentions and commitment. The fact that SC sent a senior staff person all the way to Armenia to advance the merger sent an important message that it took the process seriously.

During this time, the strategic planning process began to address key issues in a new business plan that would incorporate the merger (see Chapter 5 for details). The strategic plan spelled out the decisions that needed to be made and set tentative deadlines based on each issue's priority.

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<sup>32</sup> Thomas A. McLaughlin, *Trade Secrets for Nonprofit Managers*, New York: John Wiley and Sons, Inc., 2001, 105.

## TIPS

**Negotiations should be collegial and should focus on the intent to further a mutual mission and goals, not take advantage of the other party.** If negotiations start to break down, then barriers will go up and the process will take longer or will fail. Author Dan H. McCormick offers some strategies for avoiding these pitfalls; they can be summarized as follows:

- Take time to socialize and get to know the other party in an informal setting.
- Pick a spokesperson with an inclusive, non-antagonistic style to negotiate the controversial issues.
- Communicate from the outset that any positions held are not personal but represent the interests of each organization.
- Address the more controversial issues only after devoting adequate time to building the relationship.
- On points of disagreement, determine how much support the other party has within their organization. If that support is broad, it may be pointless to force the issue; and doing so may make it difficult to reach compromises on other issues.
- After difficult issues are discussed, allow time for emotions to settle. Major objections to controversial decisions may soften when the parties have time to review them rationally and discuss them again later.<sup>33</sup> ■

## First Step Forward: The Letter of Intent

Before the real due diligence process started in Armenia, CRS and SC management signed a Letter of Intent, also called a Memorandum of Understanding (MOU), or a Pre-merger Agreement. This document serves to initiate the merger process. Although it is not legally binding, the act of putting in writing both parties' intent to merge is an important first step forward in spelling out each party's roles and responsibilities, expectations, and rationale for the merger. In essence, the letter summarizes in

<sup>33</sup> Dan H. McCormick, *Nonprofit Mergers: The Power of Successful Partnerships*, Gaithersburg, MD: Aspen Publishers, Inc., 2001, 51-52.

writing the points agreed during the initial negotiation phase and signals to the board and management that the parties agree to pursue the merger.

The actual format of the Letter of Intent may vary depending on local legal requirements. The figure below provides a sample summary of what normally goes into a Letter of Intent.

### **Summary of Contents in a Letter of Intent**

#### **Section 1**

The subject and parties involved

#### **Section 2**

Brief description of how the agreement came about and what it is expected to accomplish

#### **Section 3**

Purpose of the Letter of Intent and expectations of the parties

#### **Section 4**

Expiration date of the letter and how it might be extended

#### **Section 5**

Any agreements reached to date

#### **Section 6**

Conditions of conduct

#### **Section 7**

Roles and responsibilities

#### **Section 8**

Signatures and dates

## **Informal Due Diligence: Lunch Dates and Field Visits**

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During the "getting acquainted" stage, before initiating a full due diligence of each other, staff at the merging organizations should seek opportunities for informal lunches, coffee breaks, and field visits to view each other's operations, meet field staff, and generally test out whether or not they really want to go through with

the merger. Simply having a conversation over food or coffee makes people more relaxed and open. In the Armenia merger, we found these interactions very useful: through informal chats in between all the business talk, we learned most of the details and a good deal of the "dirt" about each other.

Before signing a Letter of Intent, SC and CRS microfinance staff began to make branch visits together, swapping various field staff on each trip so that almost every loan officer and credit manager had a chance to meet counterpart staff and see their way of working. The discussions we had during those long hours on the road did wonders to help us break the ice, maintain a sense of humor, and build comfort and trust on a personal level. This served us well at the operational level once post-merger integration began. The period was crucial to the way the two managers' relationship developed and helped us determine the best way of working together. *It also communicated a clear message to staff about the importance of respect and compromise.*



**The Tools of Trust:  
Disclosure, Consultation, Collaboration**

Thomas McLaughlin names three tools of trust which, judging from our experience in Armenia, should be used from the very beginning (even if a signed deal is still uncertain):

- 1. Disclosure:** Early on in the relationship, disclose any facts about your organization that might lead the other party to make a different decision.
- 2. Consultation:** Agree ahead of time that no major decisions will be made without the other party's knowledge. These include decisions involving changes in major leases, job openings and hiring, plans to submit proposals, significant budget variances, and so on.
- 3. Collaboration:** Share the daily work and demands of management, and share information.<sup>34</sup> ■

<sup>34</sup> See McLaughlin, *Nonprofit Mergers and Alliances: A Strategic Planning Guide*, 100-104.

## The "Real" Due Diligence

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The term "due diligence" refers to *the systematic investigation of another organization's legal, financial, and operational status*. By the time due diligence is fully under way, you know that you want to pursue the merger but also retain the option to back out.

Conducting due diligence is an expensive and exhausting process, and it requires a strong team of experts who know the right questions to ask and how to ask them. Yet the importance of a thorough due diligence process cannot be overstated. Although neither the Armenia case nor most of the other microfinance merger cases presented in this book involved a formal due diligence process with an external evaluator, this important step can uncover serious problems that indicate that the merger should not proceed. This was a key lesson learned in the mergers involving Enlace in El Salvador, Financiera Confia in Nicaragua, and PRODEM-FIE in Bolivia. In Enlace's case, the portfolio and financial information that NGO partners were presenting to CRS proved unreliable; in the Financiera Confia case, MEDA discovered that Interfin had seriously overvalued its portfolio; and in PRODEM-FIE's case, despite an auditor's evaluation, FIE regarded the review process and the audit report as suspect.

In the Armenia case, neither SC nor CRS required an external audit of the other. For CRS, not only would an audit be expensive, but it seemed unnecessary since the rural branch of SC had performed an external audit less than a year earlier. CRS therefore saw little need to require another audit of the entire program. On SC's side, the decision not to require an external audit turned principally on the lack of finances and time: internationally certified audit firms are extremely expensive and usually need time to work a new client into their schedule. Pursuing an external audit would have caused major delays that SC could not afford, given that the funds pending with USAID depended on accomplishing the merger as an integrated part of its strategy.

In hindsight, a formal due diligence process conducted by an outside evaluator would have been useful, if only to assure both sides that a thorough and objective investigation was taking

place. However, the internal audit that SC and CRS conducted—by reviewing documents and manuals, researching legal requirements, interviewing loan staff, participating in client meetings, and conducting an extended, off-and-on exposure visit over a three to four month period—allowed plenty of time to explore the parties’ similarities and differences. The activities of the "due diligence team"—which consisted of legal counsel (local and international), managers, and field staff on both sides—also helped to build trust at the field level, since they provided additional opportunities to gather people together for open discussions of the strengths and weaknesses of each program.

A rigorous due diligence is best performed by outsiders who are neutral and can therefore produce a report that both sides can trust. The figure below provides a sample due diligence checklist of relevant documents the due diligence team should include in its review:<sup>35</sup>

### **MFI Due Diligence Document Checklist**

#### **Legal Structure and Governance**

- Charter documents, bylaws
- Registration papers, licenses
- Complete file of board meeting minutes
- Organizational chart, list of board members and key positions, and biographies or CVs of each

#### **Financial Condition**

- Financial statements (balance sheet and income statement) for all completed fiscal years, or at least three years, including the most recent period;<sup>36</sup> current year budget and narrative detail

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<sup>35</sup> Jane Arsenault, *Forging NonProfit Alliances*, Washington: National Alliance for Nonprofit Management, and San Francisco: Jossey-Bass Publishers, Inc., 1998, 119; see also McLaughlin, *Nonprofit Mergers and Alliances: A Strategic Planning Guide*, 173-191.

<sup>36</sup> While it may seem unnecessary to ask for every financial statement over a three-year period, it shows how frequently management can produce them. This is a useful indicator of how closely management follows its own finances and signals a red flag if there are long gaps or missing statements.

- All available audit reports and accounting correspondence with auditors
- Copies of payroll taxes and other proof of taxes payable
- Copy of accounting policy with description of the flow of cash through the organization, authorization policy for loan withdrawals and collections, and bookkeeping duties/separation of duties and crosschecks

### **Assets, Liabilities, Obligations**

- Current accounts payable and accounts receivable
- Copies of any insurance policies
- Proof of ownership of major assets including real property and any endowments
- Copies of loan contracts for review of format, terms, and crosschecks
- Copies of major leases, mortgages, bank loans, and any other outstanding indebtedness

### **Human Resources Information**

- Employment contracts, severance agreements, and other related personnel forms
- Consultant or other outstanding contracts
- Salary scale, benefit and incentive plans, promotion policy
- Personnel policy

### **Operations Information**

- Operations manual
- Lending policies and procedures
- Staff training policy
- Description of loan products, savings services, and other services

### **Pro Forma Financial Statements, Cash Flow**

- Current business plan
- Projected cash flows
- Pro forma* balance sheet and income statement



### Due Diligence

Due diligence will inevitably produce at least one item of concern—probably more. Here are some examples:

- **Balloon loan payments** coming due, from either the client or on a loan taken by the MFI. This will have a significant impact on cash flow.
- **General records absent or in disarray.** This could signal a system that is inadequate or altogether non-functional. In the worst case, it can signal the possibility of fraud resulting from poor internal controls.
- **Indispensable staff.** If there are one or two key people in the organization who appear to be keeping the ship afloat, the organization's strength is questionable. Losing these people during the merger could sink the whole thing. Moreover, the concentration of control in one or two people's hands increases the potential for fraud.
- **Little secrets.** These are things like relatives holding positions within the organization, a director's habit of arriving late and leaving early every day, loan officers loafing, and other bad habits that signal cultural incompatibility or outright mismanagement.
- **Unacknowledged director-staff conflict.** If people within the organization seem unhappy with their jobs or work environment, a merger could provoke employee bickering and unrest, and even mass exodus.
- **Unexamined accounts receivable/write-off policy.** If high numbers of loans or substantial loan amounts are still on the books after 160 days, overlooking them will give a misleading picture of the organization's financial health.
- **Portfolio at risk; aging of arrears.** Close attention should be paid to repayment rates, arrears, and especially portfolio at risk (PAR). If PAR is high, depending on the age of the reports, the organization may be facing an upcoming delinquency crisis, or recovering from one. This adds complication to seeing the merger through, since managing delinquency often entails enormous amounts of time and effort, and drains energy and focus away from the merger. Moreover, you don't want to import old problems into the new entity if you can avoid it. ■

Although it is important to discover any red flags early on to avoid problems later, the approach you take to finding them is equally important. If either side of the due diligence team in Armenia had assumed an attitude of suspicion, doubt, or criticism during field visits, this immediately would have put the other on the defensive and raised a barrier to openness and communication. Instead, the team tried to convey a message that it was not out to find problems and assign blame, but was simply trying to understand how things worked.

Just as you would for a normal internal audit, ***it's important to keep any discrepancies or problems you might discover during due diligence to yourself until you can discuss them confidentially with management.***

**TIPS** 

**Beware of "due rudeness" that could derail your due diligence.** One of the dilemmas the due diligence process highlights is the need to conduct a detailed inspection and at the same time maintain trust and good relations. Asking the questions that will reveal any existing problems without appearing to expect that you will encounter them is a delicate operation that needs to be handled with care in order to avoid damaging trust. A sense of humor helps. ■



# Chapter Five

## Merger Phase III: Strategic and Transition Planning

The Armenia merger was guided by two plans: a Strategic Plan and a Transition Plan.

**The Strategic Plan** spelled out the key decisions that needed to be made before the merger could take place. It assigned roles and responsibilities for a due diligence team; and it listed and prioritized the major strategic and financial issues that would need to be resolved.

**The Transition Plan** (sometimes called an *Integration Plan* or an *Action Plan*) summarized any key decisions made after the Strategic Plan was developed, and contained an extensive "to-do list" of outstanding issues and activities with provisional deadlines for completing the activities. The plan was developed through a participatory process in which managers and staff revised the business plan, established task force teams, and assigned duties to prepare for post-merger integration.

### **The Strategic Plan: General Questions to Address**

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The first task of the planning process in Armenia was to list everything we could think of that needed to be addressed. It was important to ask ourselves what decisions could be made early in the game, what could be deferred, and what sticking points or obstacles could be anticipated.

The figure below shows a summary of questions to ask as a starting point for strategic planning.<sup>37</sup>

### **Questions to Guide Strategic Planning**

1. What changes to the business plan will be necessary?
2. How will we choose senior management for the merged entity?
3. What financial impact will the merger process have?
4. What will be the agenda for due diligence and who will perform it?
5. What will be the short-term and long-term staffing requirements and organizational structure?
6. What process will be used to hire/fire and communicate other staffing decisions?
7. When and how will we announce the merger to employees and clients?
8. What new policies and procedures will need to be designed/adapted?
9. How, when, and by whom will those policies be implemented?
10. What office facilities and other support will be needed for immediate growth in staff size and clientele?
11. How will staff be trained in the new procedures?
12. How will effective communication flow be achieved and maintained?
13. What obstacles to the integration process can be anticipated, and how will they be addressed, and by whom? (lines of authority, division of roles/responsibilities)

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<sup>37</sup> The strategic plan for the Armenia merger was developed by SC Technical Specialist Kim Alter and was based on ideas from private sector consultants with merger experience, and with reference to the following source: Timothy J. Galpin, and Mark Herndon, *The Complete Guide to Mergers and Acquisitions: Process Tools to Support M&A Integration at Every Level*, San Francisco: Jossey-Bass Publishers, Inc., 2000.

Answering the questions on this list generated new questions, which we grouped into ten categories:

1. Staff
2. Governance
3. Technical Assistance/Training
4. Operations
5. Due Diligence
6. Methodology and Loan Product
7. Asset and Debt Transfer
8. MIS/Accounting/Reporting
9. Financial Analysis
10. Deal Breakers

In each category, we identified:

- A) key questions to address
- B) the method or activity to be used in addressing them  
(e.g., small group discussion, management review, or audit)
- C) person(s) responsible for each item
- D) tentative time frame for completing each task
- E) priority of each task

## Assigning Roles and Responsibilities

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Determining who would play what role and when proved difficult. Because of the reality of distance, decentralization, and division of responsibilities, negotiations took place at the headquarters, regional, country, and program levels. Despite the Strategic Plan's clear identification of tasks and persons responsible, there were not only too many cooks, but too many kitchens as well. At times, it was unclear who was making decisions within each organization and what the agendas were. This caused undue stress and uncertainty at the field level.

Multiple layers of authority, and a need for consensus building (as was the case for CRS), can slow the process and cloud the procedures for determining who does what next. This is especially the case for international aid organizations, whose headquarters must oversee activities in many countries at once.

The lesson learned the hard way in Armenia was that it is very important to put down *in writing* not only who will be the decision-makers, but also what will be the procedures for implementation—and communicating this clearly to everyone involved.

## Choosing an Executive Director

In Armenia, the choice for executive director of the new merged entity was an easy one, since part of what attracted CRS to the merger was its confidence that SC's microfinance manager could provide the local leadership that CRS needed. In many mergers, however, this choice is less clear. This was the case for Financiera Confia in Nicaragua (discussed in Chapter 4).

Choosing an executive director can turn into a contentious and potentially nasty issue if it is not handled carefully. Consider these options:<sup>38</sup>

- Let the two executive directors work it out for themselves. This may be the best solution if both directors are deemed capable of leading the organization and the planning committee is confident that they can handle this decision in a professional manner. If both are in favor of the merger and understand their own strengths and weaknesses, they should be able to determine who would be best in the lead role.
- If there is no clear choice, stress objectivity on the part of the planning committee, and develop clear criteria for choosing the person whose qualities best match the requirements of the position. Advertising the executive director position in an attempt to make the process "fair and open" may not be wise, unless there is demonstrable concern about both candidates' abilities. Creating artificial competition can undermine staff members' confidence in the chosen person.
- If the choice is clear, the committee should either place the manager who is not chosen to lead the new entity in another position in the organization if appropriate, or

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<sup>38</sup> These suggestions are adapted from McLaughlin, *Nonprofit Mergers and Alliances: A Strategic Planning Guide*, 198.

assist the person in finding another job outside the organization. In most cases, it is better not to assign a former executive to a secondary role in the merged entity; this can result in divided loyalties and even conflict of interest when employees' continued ties to their former bosses interfere with the new manager's ability to lead, as was the case for Eco Futuro's General Manager in Bolivia.<sup>39</sup> If all else fails, hold a goodbye party for the person leaving to smooth things over and end on a positive note.

- Once an executive director is chosen, it is crucial for him/her to take command immediately, even if the new entity is far from being officially or functionally merged. The longer there are two heads, the more confusing the process is and the more difficult it is for staff to see the merger through.

## Outside Help

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As discussed in Chapter 4, hiring an outside consultant who is experienced and objective can be very helpful when two parties begin discussing the possibility of merging. The same is true during the planning process, when crucial and potentially controversial decisions are being made. An outside expert can help keep the merger process moving and on track.

During the strategic planning process in Armenia, SC and CRS asked the same trusted consultant who had helped launch the negotiations to return and assist field management with those initial tough decisions, and to facilitate the first workshop with the staff teams from both organizations. Her visit not only got the process going but signaled to everyone that the merger was for real.

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<sup>39</sup> Correspondence with Gonzalo Puente, former General Manager of Eco Futuro, Bolivia, October 2001.

## TIPS

**When an outside consultant is hired jointly by both parties, be clear at the outset about selection criteria and payment arrangements.** Decide ahead of time how the contract will work to avoid possible problems later.

**Emphasize the consultant's facilitator role to ensure the organizations' ownership of decisions made.** Whereas for-profit businesses involved in mergers use facilitators as agents of private interests, NGOs use them as neutral facilitators. Because the consultant used in the Armenia merger was perceived by staff as a neutral party with both organizations' best interests in mind, she was able to play a number of roles—cheerleader, coach, planner, and referee—in order to resolve problems and advance the agenda. Most important, she was a skilled facilitator and made sure that *we* made the decisions—which was crucial, as we would have to live with them if things got difficult later. This sense of ownership was critical for staff buy-in at all levels. ■

## The Transition Plan: Putting Strategy into Action

In May 2000, exactly one year after the seed of the merger idea had been planted, Micro-F and Kamurj staff from all the branches came together for the first time to address key questions for a new business plan and create a Transition Plan that would lay out the preparatory steps for streamlining policies and procedures.

The figure below outlines the issues addressed during the Transition Planning Workshop. The workshop employed a participatory method for staff to reach agreement on how to streamline methodology and procedures. The decisions made during the workshop were later put into writing to create the transition plan.

### Armenia All-Staff Transition Planning Workshop: Key Issues Addressed

#### Mission & Objectives

Mission statement

Vision statement

Values  
Corporate strategy  
Marketing strategy, linkages, networking  
Name and logo

### **Methodology**

Client profile/criteria for participation  
Group size  
Loan size  
Loan terms/repayment  
Interest rate/fees  
Savings/internal account lending  
Loan review and approval  
Credit delivery  
Impact monitoring

### **Portfolio Performance**

Portfolio quality targets  
Portfolio growth and outreach targets

### **Internal Control & Monitoring**

Cash management  
Security  
Audit  
MIS  
Staff monitoring and reporting systems

### **Human Resources**

Governance/board member profiles  
Salaries and incentive structure  
Current staff members, new appointments/  
title changes  
Recruitment plan  
Performance evaluations, promotion policy

### **Training**

Training needs  
Training schedule  
Materials development

### **Project Teams and Deadlines**

Type/composition of project teams  
Election of team leaders  
Workplans and deadlines for team activities

In preparation for the Transition Planning Workshop, staff from both organizations held a social event to break the ice and set a positive mood for the work they would be doing the next day. The "Merger Engagement Party" brought together technical advisors, country directors, program managers, and all field staff from both CRS and SC to celebrate the official launch of the merger process. Naturally, the introductions and obligatory mingling early in the evening were somewhat uncomfortable, but by the end of the night, both teams were on the dance floor together and were reluctant to leave the party.

Using visible images to break down the divisions between the two sides also helped. For example, all the logos for SC, Micro-F, CRS, and Kamurj appeared together on one "wedding" cake. We also distributed T-shirts that had a zebra design on the back to symbolize the meshing of two distinct colors into one body. The sight of every person in the same T-shirt sent a clear visual message that we were all joining one team. These details conveyed a clear message to staff that this was going to be a positive change that warranted celebration, not fear.

This event also provided a topic of conversation to help break the ice at the workshop the next morning. When difficult issues arose and made the participants tense, references to memorable events from the engagement party the night before lightened things up and made everyone laugh. Starting from—and frequently returning to—the social element was crucial to working together productively.

**“ STAFF  
QUOTES ”**

"My advice to other people about mergers is to try to create personal interest in the merger process for every single staff member if possible."

**–Maria Hovumyan,**

Credit Manager/Trainer, Micro-F Yerevan Office

## TIPS

**Keep the merger Strategic Plan brief.** There is little need and no time to go into much depth. As long as you cover the key issues, the details and proper language can be spelled out later in a formal business plan for the new entity.

**Don't wait until the deal is signed to begin transition planning.** Starting early will increase the yield of due diligence, clarify the goals of negotiation, and define the steps to be taken immediately after the agreement is signed. In Armenia, just two months after creating the strategic plan, we began transition planning—even before the Letter of Intent was signed.

**Make sure that staff and clients hear about the merger in person, from someone close to them.** Loan officers should inform clients, and top managers should inform staff. Top management must be directly involved, face to face, with selling the merger to their employees. Impersonal e-mails, letters, or TV, radio or newspaper announcements won't cut it.

**Announce the creation of new jobs immediately to compensate for any that are lost.** If redundant positions and necessary downsizing are an issue, be up-front and also announce new job openings to soften the blow and motivate current employees to remain with you.<sup>40</sup> ■

## Task Force Teams

Employees have greater buy-in when they are allowed to contribute to the decision-making process in some way. Involving staff also ensures that they will perceive the procedures used to reach decisions as fair. Using small teams to accomplish certain tasks is a good idea for both the strategic planning phase and the implementation (action) phase. The scope of a task force team can be as broad or as narrow as the situation demands.

**Strategic planning teams.** The team created for the strategic planning phase—sometimes called a "merger design team," "merger planning committee," or "merger steering committee"—is in

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<sup>40</sup> These tips are based on ideas from Mark Heitner, "The Thorny Business of Merging Rival Firms." *Mergers & Acquisitions*, Jan/Feb 1998.

some cases supplemented by subcommittees to which technical or other specific tasks are delegated.

In the Armenia case, this team consisted of the two microfinance program managers operating with close guidance from SC's Economic Opportunities Technical Specialist. The strategic planning document we developed was sent for review by all the key players in order to gain their approval and ensure their commitment to the roles and responsibilities that concerned them personally.

**Integration teams.** The team created for the actual implementation of the transition plan and post-merger integration—commonly called an "integration team" or a "transition team"—acts as a coordinating body for project teams that are assigned specific tasks or concerns to address.

A key outcome of the Transition Planning Workshop in Armenia was the assignment of specific teams to work on the projects that would require the most time, research, and effort to implement. These were projects such as revising the staff incentive system, streamlining procedures, and creating new loan and administrative forms.

Volunteers were sought for each project team and were given preference, when possible, when the teams were being finalized. Finalizing the composition of the teams involved reaching a sometimes difficult compromise between the preferences staff members had expressed and the technical strengths they possessed, while also ensuring equal representation of both organizations on each team. Ultimately, this system worked well enough, and we found that staff who volunteered tried all the harder to make sure their task was accomplished on time.

Below is a list of the project teams in Armenia. On average, each project team had three to five members.

## Merger Project Teams and Responsibilities in Armenia

<b>Project Team</b>	<b>Major Responsibilities</b>
<b>Human Resource Team</b>	Develop HR forms, handbooks, procedures for screening applicants, pay/benefit plans, interviewing tools, etc.
<b>Lending Methodology Team</b>	Streamline procedures, adapt loan products, and revise operations manual (to be used as a training manual for staff) accordingly.
<b>Pre-loan/Disbursement/Repayment Forms Team</b>	Streamline pre-loan forms including loan applications, client data sheets, and registration forms, as well as disbursement and repayment forms, and client passbooks used during repayment meetings.
<b>Program Reporting and Administrative Forms Team</b>	Streamline loan officer and branch reporting forms, including repayment schedules, monitoring visit reports, and general branch administrative forms.
<b>Incentives Project Team</b>	Research available incentive plans for loan officers among MFIs around the world and develop a proposal to present to management for new criteria to include in a revised incentive plan.
<b>Training Project Team</b>	Prepare training materials and revise flipchart materials used in client orientation meetings; and assist with logistics, planning, and facilitation of post-merger staff retraining.
<b>Social/Party Planners Team</b>	Assist with planning and logistics for social and public events for publicity, team building, and workshops.
<b>MIS Team</b>	Examine management information systems in detail and plan for transfer of information from one system to another; and assist with modification of system to account for any changes in methodology as appropriate.
<b>Finance/Accounting Policy Team</b>	Examine accounting systems and policies in detail and plan for consolidation of information into a single system; and develop accounting policy manual for retraining staff.



## **TRY THIS**

### **Integration Core Team and Team Leader**

One thing we did not do but should have done in Armenia was to create a coordinating body or "core team" of project team members to facilitate communication. The coordinating body could hold regular meetings to keep employees informed of progress.

In the Armenia merger, the program managers shared this responsibility, with mixed results. With a small staff, new middle managers, and distant branch locations that complicated the coordination process, staying on top of the teams' progress in addition to meeting the daily demands of management put additional strain on us both and often caused delays until we could find time to review the teams' work. ■

The Project Team Leader is the point person responsible for accomplishing the team's work. This person should possess excellent facilitation skills, initiative, strategic/analytic skills, and technical expertise in the area assigned to the team. S/he should also be comfortable with ambiguity.

### **Project Team Leader Responsibilities**

- serve on the integration core team
- report progress and problems to the core team
- coordinate project team activities
- ensure adherence to the timeline
- coordinate team meetings
- submit weekly progress reports to integration team leader
- ensure appropriate links to other teams for coordinating and avoiding overlap

The Integration Core Team Leader provides leadership to the core integration team and coordinates the subteams to ensure that the integration process moves forward smoothly. S/he should

possess excellent facilitation skills, initiative, and strategic/analytic skills. S/he should also be comfortable with ambiguity, and should inspire respect from staff.

### **Integration Core Team Leader Responsibilities**

- decide how and when to launch teams
- hold regular meetings with core team
- update management on progress made
- ensure that the overall integration process adheres to the timeline
- ensure that the project teams receive the support and resources they need in order to achieve the results expected

### **TIPS**

**Ensure a representative balance on each team.** Every team should be made up of equal numbers of representatives from each side, insofar as this is possible.

**Keep communication constant so everyone knows the pace of progress and maintains momentum.** The work of the different teams will at some points overlap or be interdependent, making communication critical to efficient, productive work. (For example, the Training Project Team cannot complete its work without active communication with the Lending Methodology Team.)

**If you choose to appoint or elect a core team leader, beware of the potential for discontent if s/he is seen as taking sides.** The same applies to project team leaders. Appointment by management may be a fairer process in this case than "election" by staff. In the early stages, staff will tend to take sides and this can breed discontent. ■

## Planning and Timing

The amount of time that a merger process will take can be hard to estimate when you take into account the unanticipated obstacles and surprises that will arise along the way. A comparison of timelines for recently accomplished microfinance mergers reveals a range from five months for Financiera El Comercio in Paraguay to three years for Eco Futuro in Bolivia. Much depends on how well-established each partner is and how clearly developed the legal plans are for establishing a new institution or merging two existing institutions into one. Because Micro-F and Kamurj were fairly young programs, they were relatively flexible and receptive to change. However, their youth as programs also meant that more work was required to develop the new systems and procedures necessary to manage the immediate surge in growth—in both portfolio and staff—that the merger would bring about.

The figure below indicates the key dates and events of the Armenia microfinance merger. From May 1999, when the initial idea of a merger was born, to April 2001, when most staff were hired and/or retrained and operations were almost 100% streamlined, it took approximately 23 months for the merger process to be completed. Broken down by phases, the process took almost half that amount of time:

### Duration of Armenia Merger Phases

Formal negotiation and planning	3 months (March-May 2000)
Due diligence and formalizing agreements	4 months (June-Sept 2000)
Post-merger integration	7 months (Oct 2000-April 2001)

We grossly underestimated the amount of time the Armenia merger would take. This was due in large part to the fact that neither agency had ever dealt with this type of situation before and thus we had to create procedures for transferring assets, determine what

## Armenia Proposed and Actual Schedules for Actions in 2000

#	Actions	Proposed Deadline	Actual Completion Date	Delayed
1	CRS/SC Letter of Intent drafted	March 00	April 00	1 mo.
2	Letter of Intent signed by SC and CRS	April 00	April 00	0 mos.
3	Merger Transition Plan drafted	May 00	May 00	0 mos.
4	CRS and SC MF programs internally and/or externally audited	May 00	August 00	3 mos.
5	Merger agreement formally approved by CRS and SC	June 00	Oct 00	4 mos.
6	New board members identified and registered legally	July 00	Still undecided	12+mos.
7	CRS & SC MF staff joined in one office location in Yerevan	July 00	Jan. 01	6 mos.
8	CRS and SC MF staff resigned and transferred to Micro-F	Aug. 00	Oct. 00	2 mos.
9	Reporting requirements to the local tax authorities defined; formal relationship established	Sept. 00	Dec. 00	3 mos.
10	Personnel and financial policies, MIS and filing principles drafted and submitted to the Board and the Micro-F Founder	Oct. 00	May 01	7 mos.
11	Manuals on lending methodology, monitoring and internal controls, impact monitoring completed	Nov. 00	May 01	6 mos.
12	Additional funding opportunities explored and proposals drafted	Dec. 00	Oct. 00	-2 mos.

legal contracts were needed, and decide who should approve what document. While SC had both internal and external legal counsel and an established system for creating spinoffs of its microfinance programs, the merger with CRS and the legal documents required were new and unfamiliar elements. For CRS, subcontracting agreements to arrange for private funding for SC had to be designed, legal review had to be contracted out, and accounting procedures for the asset transfer had to be developed. This process took even longer since it fell during the summer months when staff often take vacations or travel on business for weeks at a time.

The merger planning process and the resulting checklists and timelines were useful for mapping who would do what and when. However, the reality didn't always match the plan. In many instances, it was more important to think creatively, be flexible, and come up with a different approach than to stick to the established plan, which provided us with a way to organize the process, set benchmarks, and measure our progress, but which needed readjusting along the way.

#### **TIMELINE**

##### **For Kamurj (CRS) – Micro-F (SC) Microfinance Merger in Armenia**

May 1999	Initial discussions of merger idea within CRS; idea encounters regional level opposition.
November 1999	SC reveals serious funding problems and operational risks to CRS. Merger idea reconsidered internally at CRS.
December 1999	First approach by CRS (via external consultant) to SC regarding possible merger.
January 2000	First (teleconference) contact between key players at headquarters and field levels.

March 2000	SC technical advisor visits Armenia for first face-to-face negotiations. Merger Strategic Plan developed. Proposal to CRS for bridge funds submitted by SC.
April 2000	Letter of Intent signed. CRS bridge funds to SC approved. Business plan for proposed merged entity revised. Micro-F registered legally as a local entity.
May 2000	Final negotiations over merger held (brokered by external consultant). Merger "engagement" party and Transition Planning Workshop held. Merger Transition Plan developed and presented to CRS's Executive Management Team at headquarters.
July/Aug 2000	Joint recruitment and hiring of new staff for merged entity initiated. Inter-branch exchanges conducted. Streamlining of operations initiated.
September 2000	Transfer of assets by SC and CRS to merged entity completed.
October 2000	All staff transferred and rehired by new institution. Merger workshop held to finalize new methodology and systems. New name and logo selected: Kamurj Microenterprise Development Fund (MDF Kamurj).
January 2001	Public inauguration ceremony for the merger held in Armenia.
April 2001	Ninety percent of operations streamlined and new policies and procedures in place.

Below is a general set of guidelines for determining the type and timing of planning activities.

**I. Pre-Merger Planning, Due Diligence, Formalizing Agreements  
(4-6 mos.)**

**Month 1**

Draft and sign Letter of Intent  
Hold strategic planning meeting  
Draft Strategic Plan  
Form strategic planning and due diligence teams  
Begin due diligence (include legal and cultural aspects)

**Month 2**

Hold follow-up strategic planning meeting (assess progress, readjust)  
Continue due diligence

**Month 3**

Hold transition planning meeting/workshop  
Draft Transition Plan  
Form transition teams and choose core team leader  
Continue due diligence

**Months 4-6**

Hold follow-up transition planning meeting (assess progress, readjust)  
Develop Post-Merger Plan (based on transitioning results to date)  
Complete due diligence  
Finalize strategic decisions (especially leadership, board/governance, staffing/personnel issues)  
Draft merger agreements  
Review and finalize merger agreements  
Sign and close the deal

## II. Post-Merger Integration (6-9 mos.)

### Months 1-3

Hold workshop to prep all staff on integration process

Distribute Post-Merger Plan and transition policy memos to all staff

Focus on three project areas<sup>41</sup> (for example, Human Resources, Incentive Systems, Program Reporting/Administration )

Assure at least 1-2 "quick win" results (see Chapter 8)

### Months 4-6

Focus on three project areas (MIS, Lending Methodology, Finance/Accounting Policy)

Hold mid-way evaluation, re-assess and adjust plan as needed

### Months 7-9

Focus on remaining project areas (Lending Forms, Training, other)

#### **TIPS**

**When planning, consider two kinds of time:  
process time and calendar time.<sup>42</sup>**

- 1) **Process time** is the amount of time spent in negotiations, meetings, research, planning and preparation for the merger. This will depend on such factors as travel distance; availability and number of people involved; existence within each organization of procedures for, and familiarity/experience with, mergers.
- 2) **Calendar time** is the length of time it takes to actually implement the merger and integrate two sets of human resources, systems, procedures, and policies. The rule of thumb for nonprofits is to allow three months, plus one month for each merger subcommittee to accomplish its task, since each one of these areas will require focused attention. If the merger takes longer than 6-9 months to accomplish, it may be in danger of falling through. ■

<sup>41</sup> Focusing on certain project areas does not mean that the other projects are put on hold. All project teams continue to work in their respective areas to meet deadlines. Here "focus" means management's review and concrete preparation to implement changes.

<sup>42</sup> See McLaughlin, *Nonprofit Mergers and Alliances*, 225-228.

**TIPS** 

**Develop a high tolerance for ambiguity and uncertainty;** have patience and a sense of humor. When things did not go as planned, we had to think on our feet, make jokes, and keep the atmosphere upbeat for the sake of staff morale and our own sanity.

**If you can't plan around holidays and vacations, capitalize on the opportunities they present.** The Armenia merger spanned two New Years' holidays and one summer vacation period. While the interruptions slowed the process considerably, the delays were unavoidable. So we used them as opportunities for team building (Christmas and New Year parties with staff) and publicity (Christmas cards sent to current or potential donors and various key SC and CRS staff to update them on progress and remind everyone that we were still intent on the deal).

**Avoid staff overload as much as possible.** Hire an outsider to guide you through strategic and transition planning; then designate a core team of people—or at least one person who will devote 100 percent of his/her time—to push the merger process and keep people working to deadlines. In other words, *treat the merger process as a separate project in itself.* Much of the slowdown in Armenia was due to overworked, overstressed managers and staff on the ground who simply could not find enough time in the day to juggle operational demands and design new procedures for integration. ■

# Chapter Six

## Legal Aspects of Microfinance Mergers

***Note: This chapter is not intended to provide legal advice, but rather to suggest legal and governance issues to take into account when considering or preparing for a merger—or some other type of formal collaboration—with another microfinance organization. Because laws and regulations vary by country, it is crucial to hire a lawyer and conduct your own research. Moreover, the issues discussed in this chapter are based on the experience of CRS and SC in Armenia; institutions operating in other contexts may face different/additional challenges.***

### Is a Merger the Right Choice?

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A merger may not be the most desirable option, if local laws and regulations governing the legal entities in question are restrictive or complicated. In fact, a true merger may not even be legally possible in some contexts. It's important to research the legal aspects thoroughly in order to understand what a merger can achieve and judge whether there is a better choice. By way of comparison, the figure below provides a sample of various forms of collaboration, ranging from higher to lower risk, cost, and loss of autonomy. These will vary by country, so it's important to check the local laws and terminology that pertain to the type of collaboration that is being proposed.

## Terminology and Concepts in Mergers and Other Formal Collaborations

Merger:

***The legal act of combining two or more separate legal entities into one legal entity with a single governing body.***<sup>43</sup>

Note that there may be different ways to accomplish this result, and different terminology that applies, depending on the country/countries or states involved.

Alliance or Affiliation:

***A range of possible formal collaborations or relationships among legal entities short of a legal merger. It can be a contractual arrangement to collaborate on one or all levels without any intended change in corporate legal structure.*** It is important to have legal counsel check the laws and regulations governing the type of alliance or affiliation contemplated, to avoid confusion with legal names and mistaken obligations that might have unintended consequences.<sup>44</sup> Also, some form of affiliation or alliance might be a good option if you want the benefits of a merger without permanently relinquishing the institutional autonomy of the relevant players. However, affiliations and alliances may be more difficult to steer since decision making tends to require building consensus among multiple autonomous legal entities, each of which is also answerable to its own governing bodies and officials. Affiliations and alliances, if all contingencies are properly thought through, can actually take even more time than a merger, and the results at the end of the effort are likely to be less clear cut.<sup>45</sup>

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<sup>43</sup> Timothy R. Lyman and Ellen Dale Willmott. "Legal Aspects of Microfinance Mergers and Affiliations: A practical discussion of the legal issues involved when microfinance institutions 'join forces'." Presented at a conference on microfinance, Bratislava, Slovakia, May 19, 2001. This work was sponsored by the Microfinance Center for CEE and the NIS; the Day, Berry & Howard Foundation's Microfinance Law Collaborative; and Save the Children/US.

<sup>44</sup> *Ibid.*

<sup>45</sup> For more information about affiliations and alliances among US nonprofit organizations, and how some nonprofits have structured them, see McLaughlin,

Partnership:

***An arrangement in which two or more people or legal entities agree to cooperate in order to achieve some common business goal, in the course of which they agree to share profits and losses.*** NGOs often use this term casually to refer to any form of cooperation—not necessarily a legal partnership. Therefore, parties agreeing to a partnership should make it absolutely clear what they intend.

Joint Venture:

***A partnership or other contractual relationship that is presumed to be of limited scope or duration—perhaps even a one-time affair.***

## Tackling the Legal Issues in Armenia

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In Armenia, SC contracted a local lawyer to serve as the main advisor for an initial assessment of how CRS's and SC's goals in combining operations could be structured legally under Armenian law. The lawyer consulted with a number of other lawyers in the country and with specialists in the Ministry of Justice, the regulatory body responsible for the type of Armenian legal entity (known as a "Fund") that SC had established for its Micro-F Program. Later, SC also involved both its in-house legal counsel and its principal outside legal counsel in the planning process.

According to the legal definitions laid out in Armenian law, the SC-CRS merger was considered a "conditional transfer of assets" (cash and in-kind). In this transfer, the Fund (a type of Armenian legal entity similar to what other countries define as a foundation) that SC had established as its legal institutional founder would receive assets transferred from both SC's and CRS's microfinance

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*Nonprofit Mergers and Alliances: A Strategic Planning Guide*, 105-110. It should be noted that nonprofit mergers in the international context present substantially different issues than mergers among US NGOs. Furthermore, the nature of the property likely to be at issue in any microfinance merger makes these very different from other kinds of mergers among nonprofits generally.

programs. In this sense, the entire transaction was not a true merger in the legal sense, since neither SC nor CRS ceased to exist as legal entities after the transfer. Rather, both microfinance programs and related staff, assets, and operational activities were transferred to the fund, thereby merging the two programs into a single new legal entity.

Timothy R. Lyman, SC's principal outside legal counsel and advisor (along with SC's in-house legal counsel Ellen Dale Willmott) in the Armenia case, distinguishes the case as a type of program merger rather than a true legal merger. Lyman's distinctions among types of microfinance mergers and the key issues he identifies related to the merger planning process can be summarized as follows:<sup>46</sup>

### **Legal vs. Program Mergers in Microfinance: Some Examples**

Legal merger: **combining two or more legal entities.**

1. Combining two or more legal entities of the same type into a single new legal entity, while extinguishing the old.
2. Combining two or more legal entities of the same type in a way that leaves one of the original entities surviving but extinguishes the other.
3. Transferring all net assets of one legal entity to another, and extinguishing the transferor.

Program merger: **combining two or more microfinance programs, which may or may not constitute a legal merger.**

1. A branch office or organization transfers part or all of a loan portfolio to a branch office of another foreign sponsor.
2. A branch office of a foreign sponsor transfers part or all of a loan portfolio to a local legal entity.<sup>47</sup>
3. A local legal entity of one type transfers part or all of a loan portfolio to another legal entity of a different type.

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<sup>46</sup> See Lyman and Willmott, "Legal Aspects of Microfinance Mergers and Affiliations."

<sup>47</sup> This was the case for SC and CRS in Armenia.

## Finding a lawyer

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The legal and technical complexities of a merger are such that institutions undergoing the merger process, or simply deciding whether a merger is a viable option, will require the assistance of one or more lawyers. If the merger involves both a US-based organization and one or more organizations that are or will be formed under another country's laws and regulations, it may be necessary to retain legal counsel from both countries.

Local lawyers chosen to assist with a merger should meet the following criteria:

### **Preferred Qualifications for Local Legal Counsel**

- Experience or familiarity with the operations and local legal and regulatory treatment of microfinance institutions. (If there is no one available who meets this criterion, find a lawyer experienced with the banking sector.)
- Experience or familiarity with mergers.
- Experience or familiarity with the current type of legal entity of the parties involved.
- Time availability and motivation (so that the merger process can be kept on schedule).

## Pre-Merger Planning Stage: Key Steps

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### **Research local laws.**

*Types of laws and regulations to investigate:*

1. Anti-monopoly laws and regulations
2. Banking and other regulated financial institution laws and regulations
3. Labor and benefit laws and regulations
4. Tax and accounting laws and regulations
5. Laws and regulations governing the formation and operation of the types of legal entities in question (including relevant filing and reporting requirements)
6. Other related laws that pertain to the current or future legal status of the merging parties

**Research "pre-merger" legal status of each merging organization.**

*Types of documents to investigate:*

1. Articles of incorporation, bylaws, charter, founding decision or other basic organizational documents (in particular, check voting requirements, and the requirements to approve a fundamental change such as a transfer of substantial assets or a dissolution)
2. Board meeting minutes regarding the establishment of the program or entity that will be merging
3. Local registration documents relating to the program or entity that will be merging under the laws and regulations of the country in which the merger will take place
4. Donor contracts
5. Major leases or other significant contractual obligations in the country where the merger will take place

**Decide on the preferred type of legal entity for the merger.**

*Some questions to ask:*

1. Under the laws and regulations of the country in question, what would be the optimal form of legal entity to carry out microfinance activities after the proposed merger?
2. Is either of the parties to the proposed merger this type of legal entity already?
3. If so, can the other party transfer net assets to it?
4. If not, can they create a new legal entity of this type and transfer assets to it?
5. If none of these options seems appropriate or feasible, is it possible to join forces through a type of affiliation or alliance other than a merger?

**Decide on the type of preferred governance for the merged entity.**

*Governance questions will hinge on the legal entities available under the laws and regulations of the country in question. Therefore, it is important that the merging parties clarify what they want in terms of governance structure as a precursor to deciding what type of post-merger legal entity they prefer. Some questions to ask include:*

1. What form of governance is best suited to the merged entity?
2. What will be the size and composition of the primary governing board and how will the previous parties be represented?

3. What will be the process for recruiting board members (or dismissing current board members, if either of the merging organizations has a governing board in the country in question)?
4. What influence, control, or ownership interest will each of the parties have following the merger?<sup>48</sup> Will either or both parties have special powers as a founder,<sup>49</sup> or more influence than the other?
5. Will either of the parties have influence or control over the merged entity through other means, such as under the terms of a grant agreement or loan agreement?
6. What will be the structure and functioning of the governing board (e.g., number and frequency of meetings, types and responsibilities of committees or subcommittees, relationship with the executive director or other officers, etc.)?
7. Does the type of post-merger legal entity contemplated allow for or require additional types of governing bodies, such as a supervisory board (a common requirement among certain forms of financial institutions)?

**TIPS** 

**To relieve a Strategic Planning Committee from painful decisions to cut board members, consider creating ancillary boards such as advisory committees or honorary trustees.**

Some individuals may actually prefer playing a lesser role, because it's less time-consuming than full board service, yet offers some form of participation.<sup>50</sup> ■

<sup>48</sup> "Influence" is used here to refer to the ability to affect activities of the post-merger legal entity without the power to control (such as the ability to name less than 50 percent of board members, or a contractual relationship between the post-merger legal entities and either or both of the pre-merger parties). "Control" is used here to refer to the legal power to determine the activities of the legal entity (such as the power to name more than 50 percent of board members). "Ownership" is a concept that doesn't apply to NGOs, which have no owners. However, some microfinance institutions are formed as commercial companies or similar entities that issue equity. Equity holders "control" an entity through their power to elect and remove members of its governing board.

<sup>49</sup> Under some countries' laws and regulations, the "founder(s)" of an NGO can have special rights that affect the ongoing governance of the NGO, such as special powers over the selection of its governing board or the use of its net assets upon dissolution.

<sup>50</sup> McLaughlin, *Nonprofit Mergers and Alliances: A Strategic Planning Guide*, 129.

## The Armenia Governance Challenge

Finding an appropriate governance structure was (and remains) a major challenge in the Armenia merger process, due to several factors:

- The legal environment in Armenia made establishing a fund, with SC as its institutional founder, the most viable legal option for the post-merger legal entity. The role of founder gave SC more influence over the governing board of the fund than is typical of SC's relationship with microfinance institutions it has formed to date elsewhere. For both SC and CRS, the extra influence that SC's status as founder provided represented an additional obstacle to promoting the principles of local ownership and governance.
- When merger negotiations began, SC still had not registered its microfinance program as a fund, and a local board was not in place. As a result, there was little sense of local buy-in during the consideration and planning of the merger, since the relevant decision making took place largely without local input, except from staff. Because of the time pressure to complete the merger transaction, this critical aspect of governance would have to be worked on after the merger, with local governance essentially established "in reverse."
- Having SC as the institutional founder also presented a dilemma for CRS, which wanted to retain some form of influence to protect the assets it was giving up to the new entity, and to ensure against mission drift. The simplest formula was to share an equal number of seats on the board. Even if SC had the final "legal say" as founder, at least the board composition could be shared equally. But neither SC nor CRS thought through the issue carefully enough before the merger, since a total board size of seven members had been decided upon, with the choice of four members split evenly between SC and CRS.

While the CRS and SC representatives could have been Armenian nationals rather than international staff, they still appeared to local participants as "pawns" of the two international organizations. This left only three board members who were "truly local" and who questioned the point of being there when they could easily be outvoted by the SC and CRS representatives.

- Because SC and CRS have very different organizational cultures, the issue of who should serve on the board was a contentious one. According to Mark Edington, SC's Director of the Economic Opportunities Unit, CRS's choice of its main partner organization's director, also a Catholic priest, as one of its board representatives made SC very uneasy, and could have derailed the entire merger if the two organizations had not been able to come to an agreement about the issue, based on the high level of trust they had already established. (See Chapter 7.)

### **Research taxation laws that pertain to a merger.**

1. What will be the tax treatment of the post-merger legal entity? Will it be different from the tax treatment to which the parties to the merger have been subject? In particular, do tax treaties that apply to the merging parties also apply to a merged entity that they might form?
2. What taxes, if any, may be incurred on the transfer of assets?
3. What tax liabilities might there be (social security, pension, etc.) for staff?

### **Investigate donor restrictions or approvals that may be needed for the merger.**

1. What approval do you need for transferring cash or property purchased by a donor?
2. Will you still be bound by existing donor agreements if transferring to another legal entity?
3. What amendments to existing grant agreements with donors, or written, signed letters of approval, may be needed?

 **EXPERIENCE****Donor Headaches**

According to ACCION USA CEO Bill Burrus, one difficulty that ACCION USA experienced during its merger with Working Capital (WC) in Boston, Massachusetts was dealing with donor funds. Donors to WC were receptive to the idea of the merger from the start, but the documentation required to transfer loan obligations from WC donors to ACCION USA turned into a legal headache. Burrus stated that "this was more complicated than we expected, and it took a lot of time to get the appropriate approvals we needed in order for the transfer to take place."<sup>51</sup> ■

**Determine applicable laws and procedures for personnel "transfers."**

1. What are the relevant employment/resignation or termination laws, and what is the best procedure for transferring staff (resignation, or termination and rehire by new merged entity?)
2. What rights, if any, do employees have if terminated from one of the merging entities, even if reemployed by the new entity?
3. Will employees' tax and social benefits be different in the new entity?

**Draft the legal documents required for the merger (e.g., agreements on transfer of assets, new registration documents and other organizational documents for the new merged entity).<sup>52</sup>**

- Letter of Intent to merge or similar document outlining the parties' intentions
- Formal legal approval of the merger by the merging parties (usually a board resolution will be required)
- Asset transfer agreement (may include a variety of supporting documents, such as a merger business plan, a valuation of

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<sup>51</sup> Telephone interview with Bill Burrus, ACCION USA Chief Executive Officer, September 2001.

<sup>52</sup> The actual legal documents, and the terminology used to refer to them, will vary widely from country to country and will depend on such factors as the kind of merger involved, the legal status of the merging parties, and the legal status of the post-merger legal entity.

assets being transferred, an inventory of tangible and intangible assets to be transferred, and a description of arrangements made with regard to staff to be transferred, etc.)

- Amendments to, or assignments of, existing contracts or leases, for the merged entity to assume obligations of the merging parties
- Agreements for ongoing funding or technical assistance to the merged legal entity to be provided by one or more of the merging parties
- New employment agreements and termination agreements with respect to existing employees
- New registration and other organizational documents of the merged entity
- Any other documents legally required for this type of merger in the country in question

### **TIPS**

**Watch out for country specifics when designing legal documents, such as:**

- Provisions on dispute resolution and, in the event that the two organizations are registered in different countries, provisions regarding which country's law prevails in case of a dispute.
- Language requirements (for example, all contracts in Armenia were required to be in Armenian or, if translated, to be verified and registered).
- Notary requirements (for example, in Armenia the transfer of immovable property required notary verification and state registration).
- Laws pertaining to individual loan contracts outstanding with clients, and whether each contract requires amendment or the client's consent to be transferred. ■

## **The Transaction Phase**

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### **What is an Asset Transfer?**

In Armenia, the actual merger took place via an asset transfer from SC and CRS to the locally established fund. This will

commonly be the type of legal transaction taking place, if one or more of the merging parties is an international NGO that will continue operating in its original form after the merger transaction.

The asset transfer process:

...is a means of accomplishing a merger by transferring assets from one or more legal entities to another whether by grant or sale. This includes the transfer of tangible assets such as moveable equipment, vehicles, and real property; and intangible assets such as cash, deposit accounts, contract rights (such as leasehold interests) and loans. For MFIs, these different types of assets require special attention. Remember that a loan is not the same as cash. A loan is an intangible asset that represents a borrower's promise to pay (plus any loan security such as a group guarantee).<sup>53</sup>

Long before the actual transfer of assets, consider carefully how you will handle the following issues:

#### **Asset Transfer Checklist<sup>54</sup>**

1. How to transfer cash in a safe or cash in a bank from one or more of the merging parties to the post-merger legal entity.
2. How to transfer outstanding loan portfolios. Local law may place limits on a lender's power to assign a loan without the borrower's consent. In this case, consider providing for this in loan agreements of the last cycle of loans before the merger takes place.
3. How to make post-merger adjustments to remove loans from or add loans to the books after the merger, based on such factors as the peculiarities of the accounting system of one or more of the merging parties; how to determine exact values of transferred assets for purposes of the asset transfer agreement or other documents that may require them under the

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<sup>53</sup> See Lyman and Willmott, "Legal Aspects of Microfinance Mergers and Affiliations."

<sup>54</sup> This list is representative but is not necessarily exhaustive. Other matters will arise, depending on the laws and regulations of the country in question, the situation of the merging parties, and the legal status of the post-merger legal entity.

laws and regulations of the country in question. Given the constant rotation of portfolios, if there are frequent repayments, as was the case in Armenia, the final amount transferred may be based on an approved estimate and may not necessarily reflect the precise value of assets transferred by either party at the moment of transfer.

4. How to open bank accounts in the new entity's name or transfer ownership of the merging parties' existing bank accounts to avoid stalling loan disbursements or collections. This can take time, depending on the procedures of the bank to be used and the payment system laws and regulations of the country in question. In Armenia, CRS disbursed cash to the branches in order to operate from the safe for a limited amount of time to freeze bank transactions until transfer agreements were signed and implemented and new accounts and balances were confirmed.<sup>55</sup>
5. How to perform valuations, determine inventory lists of physical assets, and fulfill any other specifics that may be required by donors.
6. How to ensure resignation or termination and rehiring of staff to be transferred to avoid gaps in staffing.
7. How to secure any amendments needed to existing contracts with third-party vendors (such as landlords).
8. How to transfer title to property purchased with donor funds or make amendments to agreements with donors for donor-restricted grants for loan capital or operating funds to be transferred.

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<sup>55</sup> Because of daily transactions for lending operations, it was impossible to have a final bank balance on the transfer agreement that would match the actual amount in the bank (by the time both parties could sign the agreement and transfer funds, the balance would already have changed). As a result, CRS operated solely from a minimal amount in the branch offices' safes for two days until the contract could be signed and money transferred to the new account in the new entity's name. This situation was not ideal and is not recommended.

## The Practical Mechanics of Loan Portfolio Transfers

Since assets were recorded differently at CRS and SC, the exact procedure for implementing the transfer depended on how each accounting department recognized the assets. Also, at the time of the merger, CRS was undergoing a transformation of overseas policies and procedures agency-wide. This meant that different departments at headquarters and at the regional level were responsible for approving different aspects of the transfer. It is important to know ahead of time what procedures exist within your organization and how they will work in order to be well-prepared for the actual transfer.

It is also important to think about an appropriate date for the assets to transfer. It is generally best to choose a date for the merger to go into effect that falls at the end of an accounting period shared by both the merging entities and the post-merger legal entity—such as the end of a fiscal year, the end of a calendar year, or the end of a fiscal quarter.

### Types of Assets and Liabilities to Consider in the Transfer

#### **Assets**

- Cash
- Securities and time deposits held by either of the merging parties
- Portfolio outstanding
- Physical (tangible) assets (such as vehicles, office equipment and MIS hardware)
- Intellectual property (including MIS or accounting software systems, rights to use logos and other trademarks, rights to use copyrighted materials)
- Donor-unrestricted grants

#### **Liabilities**

- Client savings (including cash accepted from clients as security for the repayment of loans, which may not legally constitute "savings" under the laws and regulations of the country in question)
- Donor-restricted grants
- Commercial or concessionary loans to one or more of the merging parties
- Employment contract obligations

# Chapter Seven

## Culture Clash: The Human Side

### Why Devote a Whole Chapter to This Topic?

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Organizational culture is increasingly recognized as a make-or-break factor in merger success and failure, as the recent literature on mergers indicates. In just one example, Steven I. Davis's *Bank Mergers: Lessons for the Future* identifies "the almost overwhelming challenge in human terms of blending massive and complex banking institutions" as a key concern.<sup>56</sup>

Likewise, 11 of the 12 microfinance merger cases studied by the author (McCarter, *Mergers in Microfinance: Twelve Case Studies*) cite experiences with cultural and human-relations challenges among the lessons learned. In the Armenia merger, these issues proved to be so important that management had to back up and rethink the course it was taking. (See ***The Sevan Workshop*** in Chapter 8.) This cost time and risked damaging an already delicate team-building process.

### What is Culture Clash?

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Culture is "the glue that holds people and processes together."<sup>57</sup> It's a combination of values, work rituals, norms and standards that define an organization's internal work relationships and work environment. Put simply, "it's how we do things around here," with the emphasis on we.

Some degree of culture clash inevitably results when two organizations with two different notions of "how we do things" are

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<sup>56</sup> Davis, 121.

<sup>57</sup> Mitchel Lee Marks, "Adding Cultural Fit to your Diligence Checklist," *Mergers & Acquisitions*, Nov/Dec 1999.

thrown together. Different work ethics, management styles, education levels, geographic origins, skills, experience levels and attitudes can be difficult to mesh. It's no wonder that people often say a merger is like a marriage: when not just two people but perhaps hundreds must learn to live together, the adjustments required can be daunting—even more so when one considers the many hours colleagues spend together each day.

**“ STAFF  
QUOTES ”**

"This kind of cultural, or I would say 'people challenges,' occurred at various levels. On the headquarters level (particularly for SC), there was not a clear picture of the merger idea, and also [there was] a kind of 'jealousy' about sharing our microfinance success story with a competing organization. I think this jealousy still didn't fully disappear. On the local level, the difficulties we faced during the actual implementation of the merger were a natural reaction of staff from two different international organizations resisting changes when they were not sure about the final outcome and had no example of this kind of merger for comparison. But what made the difference was that we had great people on the ground who pushed hard for the merger, who understood the real benefits, and who did everything to make it happen."

**–Gagik Vardanyan,**

*Executive Director, MDF Kamurj*

## **What are the Risks and Problems?**

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Sooner or later cultural differences will have to be addressed, and the appropriate response is not always clear. This poses particular challenges to management. In Armenia, we learned to try to anticipate the problems, and to agree early on to a shared set of standards for managing mistakes and dealing with broken promises. When deadlines got pushed back, when the incentive plan wasn't ready on time, when forms and procedures were still in fourth draft, the only thing we as management could do was to maintain honesty

and openness with the staff. While this approach did not entirely quell staff members' frustrations (and grumbling), it did gain us their respect and understanding—they knew we were trying our best.

### **Culture Clash: Who's on Board?**

One point of contention that cropped up between CRS and SC concerned the selection of board members for the merged entity. The fact that CRS is a Catholic agency and has close relations with Armenian Caritas, its sister organization in Armenia, was a matter of concern for SC. CRS was pushing for two representative seats on the board, equal to the number of SC seats, with one CRS representative from Caritas who happened to be a Catholic priest as well as the Caritas Executive Director. As a secular organization, SC was uncomfortable with the idea of a religious figure on the board. This clear cultural difference between CRS and SC could have derailed the whole process. Fortunately, the organizations' first face-to-face meeting helped alleviate some of SC's concerns, simply by providing an opportunity for SC staff to work with the CRS players in person and realize that they were competent, intelligent people. CRS was pushing Caritas not because it wanted religious influence on the board, but rather because Caritas was a trusted Armenian partner organization with competent local leadership who shared CRS's mission. Once again, what made the difference was the people involved and trust in their judgment.

Every merger will be a little different, but some common problems can be anticipated:

- **Miscommunication, rumors, periods of silence, and general lack of transparency with staff.** Mistrust and confusion are offspring of culture clash, especially if conflicts are not addressed as soon as they arise. In the worst case, this can lead to resignation and possible sabotage by employees.

- **Abrupt or unanticipated change.** Change is inevitable, but people deal with change in different ways. If changes made during a merger are not explained to staff clearly enough, or if staff do not know what to expect and when, the result can be internal chaos, stress on internal relationships, and adverse effects on clients and on the institution's public image.
- **Lack of cultural awareness or sensitivity.** Management must pay special attention early on to cultural differences on both sides, as well as individual differences involving staff members from the partner organization whom they do not know well.
- **Insufficient time.** Sometimes people simply need time to adjust. Building an environment conducive to cultural integration, where openness, trust, and a sense of unity prevail, can take much more time than is usually anticipated. It can take six months to a year, or longer, for staff to develop loyalty toward a new merged entity. It's futile to try to push something when people are not yet ready.

### **Micro-F vs. Kamurj: The Armenia Logo Design**

What's in a Name? *Everything.* That's what we discovered when we tried to come up with a new name and logo for the merged institution. At the very first workshop, where we developed the merger transition plan, we tried to make a fun exercise out of choosing a new name, which seemed like a good way to bring everyone together to address a common task creatively. We also needed a neutral name to call ourselves while the merger process was underway.

Instead, the exercise caused even greater divisions among staff because of the intense attachment each side had to its own name and logo. Name is identity, and neither side wanted to give theirs up.

Rather than pushing too hard at the first workshop, we decided to let the matter rest and bring it up again on another occasion, after emotions and attachments had mellowed. In the meantime, we held a contest for all staff members to propose names and logos.

Five months later, in October, we held a second merger workshop. We pasted all of the new names and logo designs that staff had submitted on the wall for a vote at the end of the workshop. But the same thing happened: people stuck to their original side and it came down to a matter of numbers, and which side had more and could win the vote. Even worse, this happened at the *very end* of the workshop. We couldn't let things finish on a sour note; we took a break for lunch and then made everyone come back into the training room again for a final vote.

This time, we played a game first, called the "human knot." Everyone had to hold hands, then follow instructions like "move under this arm," "step over that arm," etc., until every person was uncomfortably tangled up. Then the group had to work together to untangle themselves. When everyone was back in the circle still holding hands, we explained the point:

We often say that when people get married, they "tie the knot." That was exactly how we all felt during the merger—in an uncomfortable knot. How many people were married and understood the time it took to make that knot comfortable and learn to compromise on certain things? It wasn't easy, and some staff still didn't get it, but when we did a revote, the results were different and the numbers indicated that not everyone voted based on loyalty to "their side." At last, we had a name and logo. Our childish game had actually brought professionalism back into the process.

## Managing Cultural Integration

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*Cultural management is so critical because conflicting assumptions, practices, values and beliefs, and the ways in which they are manifested, can thwart effective communication, decision making, team building, flexibility, learning, productivity, and therefore, realization of the very opportunities that drove the union.<sup>58</sup>*

—Paula Love and Steve Gibson

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<sup>58</sup> Paula Love and Steve Gibson, "Hidden Sore Points Can Thwart A Culture Match," *Mergers & Acquisitions*, May/June 1999, 51-56.

Managing cultural integration effectively can be tricky. The following guidelines and tips on conducting cultural due diligence can help.

**Be sensitive to the fact that one side will bear the greater burden of change.** A merger is rarely a union of equals. The reality is that the bigger, more advanced, or stronger organization often takes the lead. This was a sticking point in Armenia, since it led to a feeling of "winner" versus "loser." Loan officers were already used to their "tried, tested, and true" lending methodology. They had worked hard to understand group lending methodology, and every officer's "psychological approach" with clients was slightly different, but everyone had found a way to make it work for him or her. When we started to change things around, people got upset and feared that the change would affect their performance and their incentives. Because SC's Micro-F program was older and had had more time to test the products and methodology, streamlining the two methodologies required the most change on CRS/Kamurj's part. This inevitably provoked resentment among the Kamurj staff. Though it's far from simple, the solution is to try to create an environment in which both sides feel that they are winning.

**“ STAFF  
QUOTES ”**

"First I was excited about being involved in the process of forming a new institution. But then I became indifferent. I felt like we were just doers and we implement only what the (Micro-F) head office says."

**–Dzyunik Vanesyan,**

*Loan Officer, Kamurj Vanadzor Branch*

**Explore cultural differences early on, and don't be afraid to speak openly about them.** Knowing how to manage cultural integration means doing your "cultural due diligence" from the very start. Here are some pointers from Paula Love and Steve Gibson:

- Assume that there will be differences and that they will lead to problems.
- Hold focus groups and interviews with staff at various levels to discover and articulate those differences.
- Appoint a special cultural due diligence task force team and commission to hold focus groups and explore such things as mission, vision, name (identity), what employees value about their organization, what they don't value, and what they want to keep.
- Include various levels of staff in due diligence, especially middle managers or direct field supervisors who can spot potential obstacles and assess the "chemistry" between the two sides.
- Once you examine differences, put them in writing to be clear.
- Share the differences and encourage each side to see things from the other side's perspective—what techniques and practices used by the other side are sensible, useful and valuable?
- Get objective outside assistance to guide this process in the beginning.
- Involve all staff in creating the new culture. Ownership is crucial to creating systems that will work for both sides.<sup>59</sup>

### **Learning to Embrace Change**

People naturally resist change. Opportunity International's Russia Country Director, Stacie Schrader, notes that "people, particularly those living in very unstable environments, are frightened of change." During the FORA Fund merger, she says, "I underestimated people's fear of change and what that fear could make them do."<sup>60</sup>

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<sup>59</sup> *Ibid.*, 56.

<sup>60</sup> Correspondence with Stacie Schrader, OI Russia country director and chair of FORA, Stacieschrader@cs.com, November-December 2001.



## **TRY THIS**

### **Using formal tools for cultural due diligence**

Formal tools have been developed for companies to use when doing cultural due diligence. For example, the "Merging Cultures Evaluation Index" (MCEI) from Abitibi-Price is a questionnaire aimed at analyzing cultural orientations such as concentration versus diffusion of power, innovation versus tradition, wide versus narrow flow of information, consensus versus authoritative decision-making.

The "Cultural Assessment Worksheet" developed by merger consultant Ron Ashkenas is another tool that focuses on ten dimensions of cultural difference, such as innovation style (using tested approaches versus experimenting with new methods), formal versus informal communication styles, solution sharing (frequency of sharing ideas across departments), and work orientation (emphasis on processes versus measurable results).

Also, Catholic Healthcare West (CHW), a network of hospitals and care facilities in the US, requires cultural due diligence as part of its screening process when looking for new partners. The CHW due diligence team reviews documents such as employee handbooks, compensation materials, and employee survey results, and solicits information about a potential partner's culture from external consultants, customers, and other outside sources.<sup>61</sup>

In the end, checklists and formal tools to measure cultural differences can only do so much. It is not possible to eliminate culture clash entirely, and there is no one solution to managing the clash. Cultural balancing and negotiation is not an exact science. With this in mind, the best thing you can do is simply not ignore differences. If all the other pieces fit, if you can keep going back to the common mission, and if culture stays on the table for open discussion, then people will eventually learn to work through their differences. ■

<sup>61</sup> Love and Gibson, 56.

In Armenia, this resistance to change was gradually eroded not so much through managers' conscious effort as through staff members' necessary preoccupation with the very complex and demanding tasks associated with handling an institution's sudden growth. So many new positions opened up that, with new people coming in and the existing systems needing improvement and modification to deal with the massive increase in clients, staff had to focus on their responsibilities and didn't have time to worry about what the merger would mean. Managers helped by constantly repeating the message that "change is good and inevitable, so get used to it."

**Develop a plan to implement cultural integration.** Plan for cultural integration as you would for all other operational aspects. As with the due diligence team, dedicate a cross-functional team (not just human resources people) to develop and implement a plan to effect change and manage the change like a project, with goals measured and communicated to everyone.

**Don't let one bad apple spoil the whole bunch.** Select and retain staff whose personal values match the organization's values. This should be part of any recruitment process. But if you find one employee who just does not want to cooperate and whose bad attitude starts to spread to the others, then it may be time to throw that bad apple out. It's important to act early in the process to dismiss those who do not support merger goals.

**Hold social events.** Social events held early on get people together, reduce the element of "the unknown," start building friendships, and simply let people have fun. They're also a good way to start establishing rituals and ceremonies for building a

**“ STAFF  
QUOTES ”**

"At first all the changes made me nervous. But now I think it's great since you see the results after so much hard work."

**–Lusine Simonyan,**

*Junior Loan Officer, Kamurj Vanadzor Branch*

common culture for the new merged entity. In Armenia, we organized frequent branch exchanges and paid visits to give staff members a chance to spend a few days at another branch. This increased our travel expenses considerably, but it was well worth it. Visiting a branch also meant sharing small dinners, or having cocktail parties or other small celebrations to get to know one another outside of work. But remember to be sensitive and set the right tone for major merger celebrations. In the beginning especially, some staff may feel as though they're attending a funeral rather than a celebration.



**TRY  
THIS**

**Funeral versus Celebration?**

At one merging firm in the US, employees held a ritual "funeral," placing in a casket items that represented what they felt they were losing. It provided an opportunity to acknowledge their perceived losses openly and together rather than alone or in side conversations.<sup>62</sup> This might be a useful exercise to do during a merger workshop in order to recognize that some staff will need to mourn. It gives employees a chance to be open about their feelings and concerns rather than letting them fester. ■

**A final word on culture: building a new team**

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Cultural integration is not a finite process that will conclude at a fixed point in time. It is an ongoing, evolutionary process in which the merged entity will continue to adapt and develop its new identity. In Armenia, growth forced everyone to adapt to a new way of doing things. Also, bringing in new people from the outside as new positions opened up helped over time to diffuse the tendency among original staff to take sides.

Culture clash may be a problem that you will never really solve no matter how hard you try or how much you discuss it. After the

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<sup>62</sup> *Ibid.*, 56.

workshop in Sevan, one loan officer wrote on her training evaluation that it did not accomplish one of the objectives of the workshop: building one solid team. "WE ARE *NOT* ONE TEAM," she wrote in big, bold letters.

**What do you do when people simply don't want to act as a team?**

- First, be patient and give it time. It may be best to let the two cultures operate side by side until emotional attachments diminish.
- Second, try to keep the focus always on where you are going, not where you have been.
- Third, if, more than a year after the merger, there are still serious divisions between the two sides that interfere with work performance, then it may be time to "impose" a culture. Strong leadership is crucial, and this means that senior managers must set the right tone, reward tolerance and compromise, and penalize (or get rid of) those who lack professionalism.

**“ STAFF  
QUOTES ”**

"My advice to other people about mergers is you can overcome the main difficulties of the merger process when you have the support of your top management. And of course, you have to think about staff feelings."

**–Hasmik Hakobyan,**

*Branch Manager, Kamurj Gyunri Branch*



# Chapter Eight

## Merger Phase IV: Post-Merger Integration

*You are staring at the longest to-do list you have ever seen. It is a mind-numbing, morale-destroying, ego-deflating litany of actions that makes your knees buckle.*<sup>63</sup>

—Mark Feldman and Michael Spratt

On September 30, 2000, the SC and CRS microfinance programs in Armenia officially merged to create the (then still unnamed) Micro-enterprise Development Fund. Yet a long list of crucially important, should-have-been-done-yesterday issues remained to be addressed. The merged entity still didn't have a mutually acceptable marketing name, none of the project teams had made much progress with their tasks, and the planned streamlining process was proceeding very slowly.

Managing merger integration is never a step-by-step process—everything is a priority and several critical activities are underway at any given time. Being able to manage integration requires significant advance preparation, careful planning (and replanning), extreme organization, and an ability to respond quickly to changing circumstances and emerging obstacles in order to stay one step ahead rather than two steps behind.

Several of the microfinance merger cases presented at the end of this book, including those involving FORA Fund in Russia, Eco Futuro in Bolivia, and Financiera El Comercio in Paraguay, highlight the need to speed through the merger process as quickly as

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<sup>63</sup> Mark Feldman and Michael F. Spratt, *Five Frogs on a Log: A CEO's Field Guide to Accelerating the Transition in Mergers, Acquisitions and Gut Wrenching Change*, New York: HarperCollins Publishers, 1999, 46.

possible and keep its time frame tight. The advice is sound; the big question is *how to do it*. In Armenia, our process would have been less difficult and painful had it drawn more from lessons identified in the literature and exemplified in various cases—lessons concerning how to be ready, be quick, and be organized. This chapter is less about how we did things in Armenia than about how we would have done things if we could do them over.

### **Post-Merger Workshop Agenda**

#### **DAY ONE: Opening Workshop**

Welcome, Review of Agenda, Objectives, and Expectations for Workshop

Kamurj MicroEnterprise Development Fund

*Current status*

*Merger: goals and opportunities*

*Overview of Business Plan*

*Organizational structure and expansion plans*

*Human resource issues: new hires, draft personnel policies, new staff contracts*

*Internal controls*

Evening: dinner and preparation for next day's presentations

#### **DAY TWO: Methodology and Systems**

Warm-up and Objectives of the Day

Methodology: Presentation by Manuals Project Team

*Loan product overview: Loan size, group size, interest rates, etc.*

*Group formation, loan approval process, current visits & monitoring*

*Question and answer period*

Pre-Credit Forms: Presentation by Forms Project Team

*Distribute samples of forms*

*Question and answer period*

Group work: New Materials Development

*Groups 1,2: new content for bylaws*

*Groups 3,4: new orientation materials*

*Group 5: finance-related materials*

Delinquency Management and Lessons Learned:

Presentations by each branch

*15-minute presentation on steps used to prevent and manage delinquency*

*Brainstorming: "best practices" delinquency management procedures*

Loan delivery and collection:

*Delivery Strategies for Disbursement and Repayment*

*Presentation by Sisian Branch*

Program and Administrative forms: Presentation by Forms Project Team

*Overview of related receipts/forms and reporting to head office*

*Question and answer period*

Evening: dinner and activities night

### DAY THREE: **Staffing, Training, Future Plans**

Warm-up and Objectives of the Day

Group work: Marketing and Promotion

*Brainstorming session on how to reach more clients*

*New product innovation, advertising*

Staff structure and salary scale:

*Presentation by Incentives Project Team*

*Distribute draft Incentive Plan for discussion*

*Question and answer period*

*Group work: brainstorming on non-monetary incentives*

Short- and Long-Term Training needs

*Develop 6-month training schedule*

*Develop wish list training agenda for next 12 months*

Project Teams' Work plans: Replanning for Completion of Tasks

## **Four Steps to a Well-Managed Integration Process**

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Nothing can destroy your firm's competitive ability faster and as profoundly as a mismanaged merger integration.<sup>64</sup>

—Thomas Grubb and Robert Lamb

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<sup>64</sup> Thomas M. Grubb and Robert B. Lamb, *Capitalize on Merger Chaos: Six Ways to Profit from Your Competitor's Consolidation and Your Own*, New York: Simon & Schuster, Inc., 2000, 84.

In their book *Capitalize on Merger Chaos: Six Ways to Profit from Your Competitor's Consolidation and Your Own*, Thomas Grubb and Robert Lamb emphasize that momentum is everything: an integration process that moves too slowly can stall and derail the whole merger process. But it can be tricky to implement "fast-track integration," as Grubb and Lamb call it, without losing the balance between speed



## **WARNING**

### **Manage Expectations**

In October 2000, a full three months after the intended date, Micro-F and Kamurj staff met at Lake Sevan for the long-anticipated merger workshop that would bring together all the preparatory work, based on the Transition Plan, that project teams had done to date. Our ambitious agenda was to resolve as many outstanding operational and human resource issues as possible, and then to determine how and when to begin the actual integration. Unfortunately, completing the work required to streamline procedures, create new policies, and make crucial decisions on so many different issues took much longer than we had anticipated. We managers were not as prepared for the workshop as we had wanted to be, but we did not want to delay the workshop any longer for fear of losing momentum and stalling the whole process. As a result, we had inadvertently built up employees' false expectations that the workshop would answer all their questions.

The workshop was not a total disaster. In fact, we learned some valuable lessons that in the end brought people back together, made us refocus, and pushed us through some critical issues that needed to be addressed in the open. But looking back, it is clear that we violated several of the "best practices" in post-merger integration that are outlined in this chapter. Those best practices include:

- Preparing adequately; anticipating potential areas of resistance
- Establishing realistic expectations and timeline
- Maintaining momentum and avoiding delays that can adversely affect team building and staff morale
- Communicating well with staff, acknowledging delays, and making clear, concrete schedule revisions accordingly
- Addressing the most contentious and sensitive issues (like human resources) early enough to prepare staff for what's coming ■

and calculated decision making. The following guidelines, based on our own mixed experiences in Armenia, and on various best practices identified in the literature on post-merger integration, suggest some ways to achieve a balanced, well-managed merger integration.

## **Step 1: Be Prepared. Be More Prepared. Be Even More Prepared.**

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In Armenia, we developed a Transition Plan shortly after the Strategic Plan. Doing this so early in the process was very useful; but then we failed to update the plan in more concrete terms as the asset transfer date drew near. By the time SC and CRS closed the deal, our timeline had changed considerably: as we had encountered delays on major decisions to come from project teams' work, we had revised schedules in an ad-hoc manner with each project team. But what we needed was an explicit Post-Merger Plan, distributed to all project team leaders and key staff, that would recognize the delays and clarify in writing what should happen and how. Without such a plan, it was as if we were left with an outdated roadmap that still had the old names for roads. In short, we were not well prepared.

### **“ STAFF QUOTES ”**

“My worst moment during the merger process was when methodology, procedures, new forms, etc. were not prepared well enough, and this led to different working styles between branches and a misunderstanding of how long we would have to wait before everything was settled and standardized.”

**–Hasmik Hakobyan,**

*Branch Manager, Kamurj Gyumri Branch*

## **Step 2: Determine the Degree of Integration You Want**

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The first thing to consider in a Post-Merger Plan is what degree of integration will be most appropriate for the MFI: minimal or full integration. Below are two definitions:<sup>65</sup>

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<sup>65</sup> *Ibid.*, 89-94.

**Minimal integration:** *when merging firms run as stand-alone businesses and then combine revenue and profits at the end of the accounting cycle.* Grubb argues that "fully 50% of acquiring firms in the 1990s would have had better results if they had implemented this choice."<sup>66</sup> His reasoning is based on the fact that firms failed to consider the infinite degrees of full integration, and the organizational energy, focus and commitment needed to make it successful. Most firms failed to produce results because of the confusion involved and the time lost.

**Full integration:** *when merging firms meld together 100 percent of systems, assets, practices, and people into one united firm.* To integrate fully with success, you must consider in advance the exact shape and composition of the integration: Will you 1) adopt 100 percent of one firm's systems and best practices; 2) first research and evaluate both firms, then select the best practices from each; or 3) reach a balanced compromise between firms?

### **The Best of Both Worlds**

The Armenia merger chose full integration, since taking the best from both organizations was one of the advantages we believed the merger could yield. Given that choice, it made sense to learn from both methodologies, discover what clients liked best, and determine what had worked most efficiently for each organization. This required extra time and effort to organize and repeatedly convene focus groups of both clients and staff members; to discuss, analyze, and review our findings; and only then to decide. This process was slow and cumbersome, but we felt it was worth it in the end.

At first, SC and CRS assumed that the only way to maximize efficiency and ensure manageability would be 100 percent standardization of products and lending procedures. However, further investigation indicated that certain variations among branches were good and offered an opportunity to pilot

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<sup>66</sup> *Ibid.*, 91.

different products first and allow more time before introducing them across all branches. As long as systems and procedures could run in tandem, and any variances were clearly explained and understood by staff, this worked quite well.



### **The Little Things That Count**

DaimlerChrysler, a leading car manufacturer in the US, coordinated a series of first changes to communicate readiness and positive energy to its employees. On day one of the official new company's operations, when employees arrived at work, each received a letter from the co-chairman, a copy of the new company's first newsletter, a watch with the company logo, and a message on his or her computer screen that read "Welcome to DaimlerChrysler. The future starts today."<sup>67</sup> Although these gestures required time to plan and coordinate at a very busy moment in the merger process, they sent a clear message to employees that the new company cared about them and was ready to achieve success.

Sending this message to employees doesn't have to cost a lot. In Armenia, we printed new business cards for all the managers with their new job titles and logo on them, and made new IDs for loan officers to wear in the markets. These symbols were important for helping staff to begin to identify with the new organization. We prepared individual letters of welcome to accompany new employment contracts; new office signs for every branch also reinforced the change. Unfortunately, we were not as prepared as DaimlerChrysler, and none of these things happened simultaneously, or coincided with the official merger date. With all the other things we needed to do, these things were not a priority. In retrospect, we realize we should have put these symbolic actions higher on the list. ■

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<sup>67</sup> *Ibid.*, 109.

### Step 3: Start Positive: Look for Quick Wins

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Six months into the merger process, when things hadn't gone the way we planned and deadlines kept being pushed back, everyone including management started to feel bogged down. Everything seemed to take longer than anticipated; even the smallest decision seemed laborious, and we still had as many unresolved issues as we had had at the start. This slump could have been avoided by applying Grubb and Lamb's suggestion for fast-track integration: ***start with an action plan that is designed to achieve business milestones and make sure there are three easy wins in the first six months.*** This sets the right tone, immediately builds momentum, and instills confidence in staff that positive changes can and will be made—that the organization will move through the merger integration *process* and come to focus on achieving business *results*.<sup>68</sup>

### Step 4: Remember the "3 Cs"

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In relation to microfinance—and to banking practices in general—one often hears about the "3 Cs" of credit: Character, Collateral, and Capacity to repay. Lessons learned from bank mergers suggest a different "3 Cs" for laying a strong foundation for the integration process. Author Steven I. Davis identifies these as Clarity, Communication, and Consistency.<sup>69</sup>

#### Clarity: Know Who is in Charge

Personal chemistry matters in mergers, especially at the top. You can't have two bosses forever, so one must step down gracefully and play the lesser role—or leave. Leadership is crucial to successful merger integration, and the "post-merger depression" commonly experienced demands even stronger leadership to demonstrate commitment and excitement. It requires "one of those unique individuals who successfully blends determination and vision, unique people skills and empathy, and the energy to spend 25 hours a day communicating the message as well as running the bank."<sup>70</sup>

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<sup>68</sup> *Ibid.*, 88.

<sup>69</sup> Davis, 123.

<sup>70</sup> *Ibid.*, 124.



## **EXPERIENCE**

### **Leadership is Key**

During the establishment of Opportunity Microfinance Bank (OMB) in the Philippines, a major lesson learned was the critical need for strong leadership to make the merger a success. OMB found this leadership in the person of Noel Alcaide, President and CEO of the Alliance of Philippines Partners in Enterprise Development (APPEND), who had over 20 years' experience in microfinance. Alcaide took the lead in moving the merger forward during its early stages and brought the vision, credibility, and integrity critical to the process. Later, Dr. Ricardo Jumawan, a former CEO of a major development corporation in the Philippines who had 30 years' experience in business development, assumed the role of OMB's CEO. With Jumawan at the helm, OMB was well positioned to implement the merger. Jumawan recognized the importance of selling the merger idea to the partners and convincing them to give up individual ownership in order to "build a larger vision big enough to accommodate their individual vision, and build a bigger structure to house their vision."<sup>71</sup> ■

## **Communication: Make Sure Everyone Knows What's Going On**

Constant communication between managers and staff is vital to making sure that everyone on the team knows the strategy and relates his or her role to the overall plan.

### **What to communicate:**

- Rationale for the merger (and positive strengths of the merger partner)
- Common mission and vision (this needs to be stated repeatedly)
- Staff roles and responsibilities
- Action plans for the merger (so staff know what to expect)

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<sup>71</sup> Based on correspondences with: Paul Honeyman, Asia Manager of the Opportunity International Network Investment Services Group; Dr. Ricardo B. Jumawan, Chairman and Chief Executive Officer of Opportunity Microfinance Bank; Noel Alcaide, APPEND President/CEO and Opportunity International Regional Director for the Philippines; and Susy Cheston, Opportunity International Senior Vice President, Policy & Research, December 2001-February 2002.

- Progress reports and updates (with celebrations when milestones are achieved)
- Employee impact (including any downsizing and new job creation)
- Any controversial issues (address these early on, even if they can't be resolved quickly or fully, so staff know that they are being acknowledged and confronted; this avoids conveying secretiveness)
- Most important, EXCITEMENT! (don't assume that an executive's excitement about the merger is necessarily shared by all staff; it must be communicated to them)<sup>72</sup>

**“ STAFF  
QUOTES ”**

"The best moment I experienced during the merger process was building a new team and feeling like you are creating a new institution!"

**–Margarita Lalayan,**

*Senior Loan Officer, Micro-F Yerevan Office*

**How to communicate:**

- one-on-one with each employee
- in mini-staff meetings
- via newsletters, e-mails, and memos
- in workshops
- at parties
- with well-chosen words (how you say something can be more important than what you say)
- through actions

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<sup>72</sup> Nathan Ainspan and David Dell, "Employee Communication During Mergers," *The Conference Board*, Report Number R-1270-00-RR, [Http://www.conference-board.org](http://www.conference-board.org), June 2000, 22.



**TRY  
THIS**

**The Merger Minute and F.U.D.**

When US-based Duke Power Company merged with PanEnergy Corporation in 1997, it established "the Merger Minute," a daily e-mail update on the merger progress.<sup>73</sup> Daily e-mails may be too much to ask, but a weekly or at minimum bi-weekly update—even if it's only a sentence or two—will assure employees that things are progressing and that they are being kept informed.

E-mail is a powerful means of communication; even in developing countries, it's relatively cheap and easy to use it to your advantage. We were able to coordinate the project teams' work, maintain branch communication, and notify almost every employee of important developments, thanks to our internet and e-mail server in Armenia. We encouraged all our staff members to set up a free personal Hotmail or Yahoo account so that even if they didn't have a computer at the office and couldn't check their account very often, whenever they did they still got a personal announcement that made them feel connected. At the office, virtually every department or branch had a computer with an account, and each manager was responsible for printing relevant messages and posting them where his/her staff could read them.

Using e-mail to maintain a constant communication flow also minimizes the F.U.D. factor (Fear, Uncertainty, and Doubt) that sometimes characterizes employee concerns and leads to rumors and misinformation, particularly when there is not enough communication during a merger.<sup>74</sup> The nice thing about e-mail is that it is less formal than other means of communication, and users generally feel greater freedom to express themselves. While e-mail can't replace in-person communication, for some purposes it's a whole lot better than executive memos on official letterhead. E-mails are a great way to send notes of encouragement to employees and disseminate official news. ■

<sup>73</sup> HR Executive Review, "Human Resource Challenges in Mergers and Acquisitions," *The Conference Board*, 5, no. 2, 1997, 15.

<sup>74</sup> Ainspan and Dell, 15.

### **Who should communicate?**

Establish clear lines of authority so that employees know whom to ask when they have questions. This can be the executive director or another senior staff member, depending on the organization's size and the need to keep executives focused on the larger strategic issues. However, it's important for staff to feel that top managers are close to them and know and care about their concerns. Communication from an executive also demonstrates his/her respect for employees. This entails being visibly accessible (by maintaining an open door policy) and making personal visits to even the most remote branch office.

### **Who else, in addition to employees, should receive communications?**

**Clients.** Clients need to hear about the merger first, and personally, and the best people to tell them about it are the people closest to them: loan officers. Clients should be informed about the possibility of a merger long before the deal is signed. This requires preparing loan officers first, to make sure they know how to present the information accurately and positively and assure clients that the merger will improve the services they receive. The merger can put customer retention at risk if other MFIs treat it as an opportunity to recruit clients to their institution. This risk increases if the merger encounters excessive confusion or delay. In that event, clients need to be kept informed so that rumors don't take over.

**Regulators (if applicable).** Institutions that are planning a merger and fall under a government regulatory body need to inform that body of their plans and determine what formal procedures they may need to follow.

**Media.** The media may not deem your merger newsworthy and grant it coverage. Getting the merger into the news may require finding a hook that interests the media. In Armenia, personal media contacts proved very useful, but ultimately we had to pay for TV coverage during the official public merger celebration. The investment paid off: the news coverage became a marketing tool to announce ourselves to potential new clients. In the three weeks that followed, we had more interested applicants than we could handle!

## **Consistency: Maintain Momentum**

No matter how well you plan your integration or how detailed you make your roadmap, your plans will change. Maintaining momentum will therefore require you to plan in such a way that you can remain flexible and responsive when unexpected obstacles present themselves. Integration is more complex than it may seem—and it will almost always take longer than you think. The best way to keep it moving is to set targets as realistically as possible, acknowledge delays, push employees to meet targets but watch employee morale (and acknowledge their work even if deadlines must be delayed), and revise or reschedule targets as quickly as possible.



# Chapter Nine

## The Mechanics of Merging MFI Operations

Staff at both SC and CRS had originally thought that once strategic issues were resolved, the actual integration process would be fairly straightforward and mechanical. But as the process evolved, significant differences in methodology, branch structure, bank and accounting policies, staffing, and communication styles—differences that were not initially apparent—emerged to complicate integration. This experience underscores the importance of due diligence as a means to understand from the beginning the differences that will affect the merger in order to avoid surprises, and to base planning and timing on realistic expectations.

### “ STAFF QUOTES ”

"Long before the merger integration process ever starts you need to have everything settled as much as possible—like all the positions, functions, and distribution of exact responsibilities."

—Arsen Ashughatoyan,

*Accountant, Kamurj Gyumri Branch*

On the next page is a list of things to consider when planning for post-merger integration. Each area, with the exception of name/identity, is discussed in detail in this chapter. (For more about identity, see Chapter 7.)

## What to Integrate

### **Name (identity)**

- marketing name
- logo
- mission statement
- culture

### **Staffing levels**

- job titles
- reporting lines
- organizational chart
- promotion policies

### **Salary and benefits**

- salary levels
- incentive system
- medical, other insurance and benefits

### **Training and retraining programs**

- staff training materials, needs assessment, training schedules and agendas
- client training materials, including methodology training and any business skills development

### **Lending policies and procedures**

- loan products
- saving products
- other products or services
- methodology (application, disbursement, collection procedures)

### **Information systems**

- loan tracking system
- accounting system
- internal control system
- reporting and monitoring system
- impact measurement system
- filing system—forms and documents related to paper information flow

## Staffing Levels

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*A bank's resources are almost entirely its staff; successful relationship banking depends on the careful management of the bank's human resources.*<sup>75</sup>

—Charles Calomiris and Jason Karceski

### **Organizational structure, downsizing and recruitment**

The Armenia merger involved few redundant positions and thus avoided the painful process of downsizing. Staffing of both Micro-F and Kamurj was relatively lean, with no overlap between branches, since the organizations worked in different geographic areas. If anything, there were too few people, and the merger strained the small staff.

The only department that faced staff overlap after the merger was the finance department: there were three finance officers, all of whom hoped for promotion to the position of finance manager. To resolve this situation, we examined each candidate's strengths and weaknesses. One of the finance officers was promoted to internal audit. While he did not meet all of the criteria for the position, he was given a three-month probation as part of a standard hiring policy with any new position. With the other two finance officers, it was more difficult to determine who was best qualified to become the finance manager—possibly neither. Rather than initiate an external search and risk losing both, we promoted the one who had worked the longest for her respective organization, again with a three-month probation. In this case, since there was no clear choice between the candidates, basing preference on seniority was more justifiable and less demoralizing for the one not chosen, who still had hope for promotion at a later time.

The merger created several new jobs and allowed promotions where possible for current staff. With the immediate growth it created, the merger opened up new positions for internal auditors, an operations manager/deputy director, an office manager, an MIS manager, branch managers, credit supervisors, and loan officers.

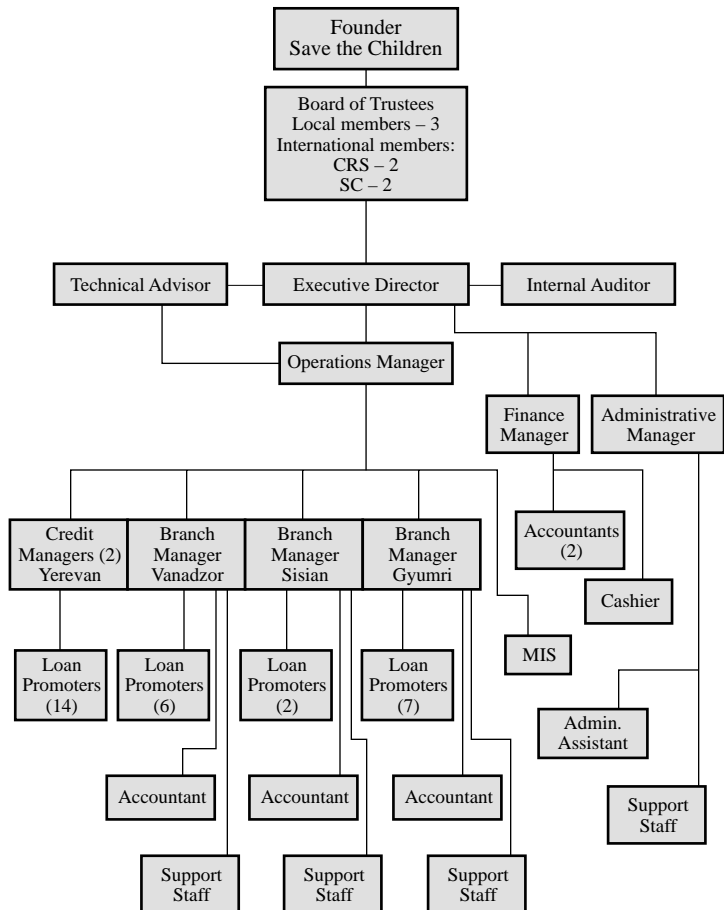
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<sup>75</sup> Calomiris and Karceski, 104.

The recruitment process for these new positions strained the merged organization but also forced it to address important human resource issues early on.

The figure below shows MDF Kamurj's organizational structure as of April 2000, when the merger process was more or less completed.

**MDF KAMURJ: Organizational Chart**  
**April, 2001**



SOURCE: Organizational Chart provided by MDF Kamurj, January 2002.



## WARNING

### Choosing the Most Qualified

One of the mistakes that some merging companies make in selecting personnel from the pre-merger entities to staff the new organization is to adhere to a rigid rule of equal representation in an attempt to achieve a "merger of equals." In the 1992 merger between Comerica Incorporated and Manufacturers National Corporation in the US, management tried to fill key positions through a system of selecting candidates alternately from each organization. The idea was to create a balanced blend of staff. While this process maintained a representative balance, it broke up teams of people who had previously worked well together, and did not allow the newly combined company to select staff based on who was the best qualified.<sup>76</sup>

Another mistake to avoid is basing selection criteria *only* on technical skills or experience. For senior and middle management positions especially, leadership qualities are crucial to guiding the organization through the strains of the merger process. People chosen for these positions should share the values that the new merged entity wants to promote and be able to manage

### Job Titles

It is important to be aware of possible resistance to changes in organizational structure and job titles. These can be sensitive issues and staff may interpret changes as loss of status. In Armenia we tried to get a sense of how staff felt about the usual job titles in microfinance organizations and to choose for the merged organization those titles that seemed to carry the most prestige. For example, Micro-F designated the person who supervised several loan promoters (loan officers) at the head office a "credit supervisor." When we started naming branch managers, we changed her title to "credit manager" to reflect the fact that she shared most of the responsibilities of, and was on an equal level with, branch managers. Thomas McLaughlin suggests to *upgrade*

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<sup>76</sup> HR Executive Review, 13.

***job titles all around to minimize people's disappointment when they are not assigned the precise role they wanted.***<sup>77</sup>

It is also important to be particularly sensitive when announcing any staffing changes. The announcement of new job titles and the new organizational chart during the Sevan Workshop turned out to be a serious misjudgment. One loan officer had been promoted to branch manager while another was made *acting* branch manager. Although each assignment was justified, we neglected to speak with the individuals involved before making the public announcement. Had we been more sensitive, we would have spared the acting branch manager unnecessary embarrassment before the whole group.

### **Salary and Benefits**

*Compensation issues have such a great impact on operations, take up so much of the budget, and present so many opportunities and pitfalls that they cannot be safely ignored or deferred by management.*<sup>78</sup>

—Stanley Foster Reed

### **Salary Levels—Retaining is Cheaper than Rehiring**

Undoubtedly one of the most feared, contentious and time-consuming aspects of integrating the Armenia partners was determining staff compensation. It was crucial to assure staff from the beginning that management would give priority to their needs and concerns and that no one would lose out. Included with the asset transfer agreement between SC and CRS was a guarantee to rehire at the same or equal salary level all staff of the merging programs (a list of their names was attached to the agreement). No staff member would be terminated until an extended probation period (at least six months after the official merger date) had elapsed. This guaranteed job security for all staff and communicated SC's and CRS's commitment to its respective program staff.

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<sup>77</sup> See McLaughlin, *Nonprofit Mergers and Alliances: A Strategic Planning Guide*, 221-223.

<sup>78</sup> Stanley Foster Reed and Alexandra Reed Lajoux. *The Art of M&A: A Merger, Acquisition Buyout Guide*, New York: McGraw Hill Company, Inc., 1999, 439.

Although there were still periods of discontent, repeated reassurances helped to maintain staff members' confidence in the new organization and keep them from leaving during the period of radical change related to integration. Even if staff members did ultimately decide to leave, this guaranteed period of employment bought them time to look for other positions and alleviated the initial anxiety and fear that the merger announcement created.

As a result, employee salaries tended to increase after the merger. But this offered us an opportunity to conduct another salary survey among competing MFIs and other industries to make sure that the salary levels we reset were competitive in the marketplace. Also, retaining employees and easing the transition by instituting a pay hike was far less costly than expending the time and effort required to hire replacements. We understood that we had to demonstrate fairness and remain true to our promises; *if people lost trust in the new organization and did not see a future there, they would leave. Open communication and reassurances were crucial during those first months of integration.*

### **Incentive Plan**

Micro-F and Kamurj each had an incentive plan for loan staff, but the plans varied significantly: Micro-F had a higher base salary and up to 30 percent incentives awarded quarterly, whereas Kamurj had a lower base salary with up to 100 percent incentives awarded monthly. Since both plans were relatively new and no one was completely satisfied with either current system, the strategy chosen for the merger was to take the best ideas from each.

The Incentives Project Team researched all available materials in microfinance literature, circulated questionnaires to staff, and held focus groups to discuss what people liked and didn't like about their current incentive plan. Then the team agreed on a list of criteria to measure and reward performance; a "wish list" of non-financial incentives that staff had suggested; and various options for combining them. These were presented in a proposal to management, who then translated the suggestions into a spreadsheet of cost calculations and percentages based on appropriate salary levels and the planned growth of the institution.

This took more time than anticipated, and the final product still needed refining and testing. But the process also ensured staff buy-in: even if there were still some complaints, everyone knew that the process had been transparent, that they had contributed to it, and that management had proven it was willing to listen, to test new ideas, and to be open to further suggestions in the future.

 **WARNING**

The time required to develop an incentive plan can take its toll on staff motivation. A major drawback in the Armenia merger was that designing a new incentive plan took longer than anticipated and was done without an interim plan. Consequently, there was a lag time when incentives were not paid at all. This process left staff waiting and wondering while the details were worked out and did little to encourage staff productivity—the object of incentive plans. Some degree of uncertainty and delay may be unavoidable, but the lesson learned here was that it is crucial to recognize the complexity of designing incentive plans, have a back-up plan in mind, and be up-front about possible delays.

If incentives are put on hold for a period of time, assure staff that current performance will be accounted for once the plan is finalized, and find ways to recognize staff through non-financial incentives, such as "Staff of the Month" awards.

Another difficulty is knowing just how participatory and decentralized the decision-making process should be. There is such a thing as being too generous and democratic in decision making, and some decisions are better left to management. Salary and incentives are a delicate subject, and while it's important to make sure that staff agree to the targets and criteria for incentives, discussing dollar amounts can open a Pandora's box that will not easily close. We found that soliciting feedback from staff and then leaving to management the decision of how to incorporate staff feedback into the final incentive plan was the safest, most efficient way. ■

### **Other Benefits**

Additional benefits rounded out the package. For example, a "winter allowance" was scheduled for every November to offset

increased costs of electricity and heating during winter months. Staff could also choose between an optional medical insurance plan in which either the organization paid the insurance premium each month or the staff member could take the cash instead. Staff favored these additions, which helped smooth over minor discrepancies between base salary and incentive levels that came up during the transition..

Adding a few new benefits at relatively little cost to the organization can do much to inspire staff members' confidence and gain their loyalty, and to confirm the new organization's integrity in the eyes of employees. The details in benefit plans will depend on the particular country's context. In the Armenia merger, the first step to developing a benefit plan for what was now a locally registered organization was to check local requirements on income tax, pension funds, and related matters to ensure the plan conformed to Armenian law.

## **Training and Retraining Programs**

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Developing a training plan for the Armenia merger took place at two levels. First, the revised business plan included an overall technical assistance (TA) plan and set a tentative schedule of training dates. This TA plan looked at institutional needs as well as individual staff training needs that had been identified during the first all-staff workshop. Second, once integration had begun, the Training Project Team conducted a participatory training needs assessment as a follow-up. The team assessed what had been accomplished to date, made a list of further training needs, and then voted on priorities. This addressed staff retraining not only on new procedures and methodologies, but also in other areas of interest to staff.

Although the list of priorities that emerged from this process was far too ambitious to achieve in one year, it yielded a clear picture of what staff perceived to be their strengths and weaknesses, and the kind of career development paths they desired.

## Training the Managers

Middle managers provide crucial leadership and ensure smooth integration and buy-in from those they supervise directly. For this reason, it is important to focus special training efforts on managers to keep them informed and on board, and to build their leadership skills. In Armenia, shortly after naming new positions, new hires, and promotions, we conducted a "New Managers Workshop" that brought together the branch, financial, and administrative managers under their new job titles to begin discussing relevant operational issues including, but not limited to, those related to the merger integration. We covered general management practices such as motivating employees, managing time, and delegating responsibilities; we also discussed rethinking job descriptions, and how managers saw their roles within the new organization.

The workshop gave us the opportunity to stress to managers their importance in the merger integration process and to ensure their personal buy-in and commitment to making it a success. Stating clearly that what took place was "behind closed doors," we encouraged managers to share any fears and concerns openly with fellow managers. This started a process of establishing closer relationships, especially among branch staff, that would help to maintain friendly communication and transparency across the organization.

### **EXPERIENCE**

#### **Training and Cultural Change: The Case of Financiera Confia, Nicaragua**

The Mennonite Economic Development Associates' (MEDA) Chispa microfinance program merged with Financiera International (Interfin) to create the first Micro/Small Business Bank in Nicaragua. In preparation for the merger during 1999, MEDA purchased technical assistance for employees of Chispa. They received intensive technical training from the

German consulting firm IPC, while MEDA and Chispa management prepared the branch offices for the merger:

- Chispa branches were renovated
- New work processes were established in response to government regulations
- A new software package was implemented
- A system was created to manage the flow of information between the branches and the head office and direct the work at the branches
- Loan products were revised to improve operating efficiency

On January 2, 2000, the parties proceeded with the operational merger of Chispa and Interfin into Confia, even though the new ownership structure had not been determined and no new shares had been issued. The branch structure was still staffed primarily by Chispa employees, and when the name on the offices was changed to Confia, they were prepared.

But at the head office, 15 Chispa staff arrived at the former Interfin office to join the 60 employees there. The new name, Confia, appeared on the sign outside, but inside nothing had changed. The Interfin employees were not prepared: they had received no training and little information relating to the merger. The prevailing attitude was that they were the "bankers" and the "NGO" interlopers would not be staying for the long term. All training for former Interfin employees had to occur during 2000, and while many were able to fulfill the requirements, there were significant numbers of resignations and dismissals during the year. As of November 2001, the Confia head office staff of 45 consisted of approximately one-third each of former Chispa, former Interfin, and new employees.<sup>79</sup>

The Confia case highlights the importance of carrying out a joint, coordinated training and preparation program for *all parties equally* prior to the merger. Rather than making each party responsible for preparing its staff on its own time, as in the case of MEDA/Chispa and Interfin, the key is to promote a unified "identity" prior to the merger with one training program conducted jointly by the parties. The high staff turnover and stress levels involved in the Confia case could have been avoided had coordinated training and preparation programs been in place on both sides. ■

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<sup>79</sup> Lehman, "CHISPA to CONFIA."

One lesson learned during the retraining process concerned the importance of distributing written draft policies and manuals to all staff *and* explaining them in person. In the place of training manuals, which would take a long time to rewrite and might have to be revised several times until new operating systems were refined, a series of instructional memos detailed any new changes and were e-mailed to branch managers. But this one-way communication method did not always work, and staff were frequently confused by the changes. To improve this system, we began following each memo with a phone call and, shortly after, a personal visit to confirm that each manager clearly understood the change and was well prepared to implement it.

## **Lending Policies and Procedures**

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Integrating products, disbursement and repayment mechanisms, and general lending methodology was one of the most challenging and sensitive tasks in the Armenia merger. This integration was the crux of successful operation, and there were enough pre-integration differences to make the process tedious and time-consuming. Some general guidelines helped:

- **Identify the easier methodological aspects to integrate and move quickly through the early decisions.** The easy decisions related to loan size, group size, interest rate, pre-loan training period, and same-day turnaround renewal. We chose the most efficient aspects of operations from each side, making minor differences between the two the basis for adding flexibility for clients. For example, Micro-F had group sizes of 7-9 members, while Kamurj had group sizes of 10-20 members. So we broadened the span to include 9-15 members in the first cycle, and 7-20 members in subsequent cycles.
- **Document and justify in writing to staff why and how decisions to change the methodology are made.**
- **When choices are not clear cut, hold focus groups with staff and clients to determine the best course of action.** Kamurj offered internal account savings services to clients on the traditional village banking model, whereas Micro-F offered

a voluntary reserve fund that was used only for loan repayment in times of emergency. Rather than making a hasty decision in favor of one or the other approach, we decided to continue to pilot the internal account in the former Kamurj branches for a period of time and held several focus groups with loan officers and clients to get their perspective on just how well this was working. Ultimately, we phased out internal accounts until MDF Kamurj could become a legal, full-fledged credit and savings institution. However, we maintained differences across branches, with reserve funds being mandatory or voluntary depending on the context.

- **Involve field staff in the decision-making process.** If you want buy-in and assurance that changes made are accepted and will work, make sure that field supervisors and loan officers are intimately involved in the integration process. On several occasions, the Forms Project Team, which included several financial officers who were skilled in computer formatting, came up with revised repayment forms and other financial forms for field-level use that were great from an accounting perspective, but were not user-friendly for loan officers or clients. It was important to have field staff review all revised documents and continue working together until we found a mutually beneficial version.

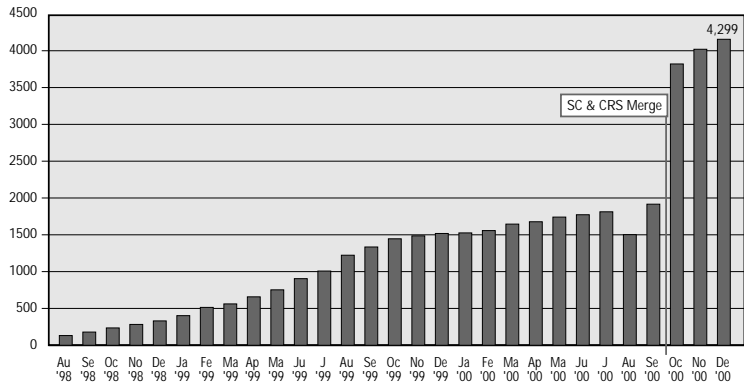
## Information Systems

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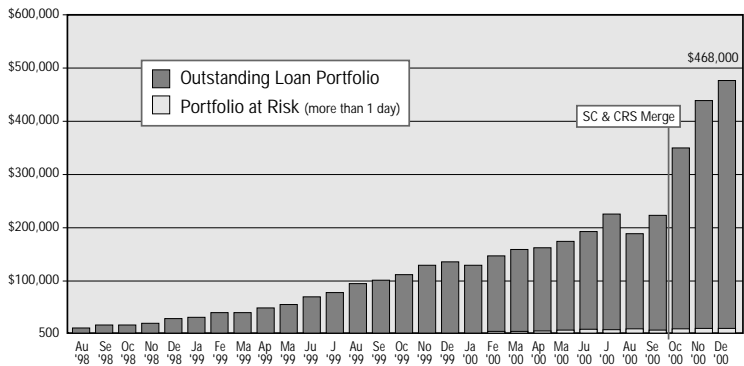
A merger can result in an organization doubling or tripling in size literally overnight. To manage that kind of growth, it must be not only humanly ready, but also technically ready. Having information systems in place that have sufficient capacity to handle the sudden growth is crucial to success. In the Armenia merger, MDF Kamurj jumped from 1,960 active clients in September to 3,900 in October, to almost 4,300 by the end of December 2000. Its portfolio likewise expanded from roughly \$340,000 to more than \$430,000, reaching nearly \$470,000 by the end of 2000. For two historically small operations with lean staffing and moderate accounting and MIS capacity, the increases presented a significant challenge.

The figures below illustrate the growth in active clients and portfolio before and after the Armenia merger.

### MDF KAMURJ Active Clients



### MDF KAMURJ Loan Portfolio Progress



SOURCE: Data for both charts provided by MDF Kamurj, January 2002.

### Loan Tracking System

Neither Micro-F nor Kamurj had management information systems in place that could handle the amount of growth that the merger would produce overnight. The short-term solution was to modify the Micro-F system slightly and install it in the former Kamurj branch offices. The MIS Project Team was responsible for examining both systems and determining what modifications would be needed and how to make them. The long-term solution involved investigating off-the-shelf software packages for an MIS better suited to the organization's needs. A common rule to follow is to find

a system that will yield 70 percent satisfaction and then go with it—designing a new system from scratch is simply too time-consuming.

The past two decades of major bank mergers echo this lesson and advise against letting your systems people mix, match and tweak two existing systems into one, or designing something new. In *Bank Mergers: Lessons for the Future*, author Steven I. Davis notes that this could turn into a five-year project.

If one of the merging organizations has a decent system, choose it and throw the other away. If not, buy ready-made. The important thing is to decide this before the actual merger

### **Accounting System**

Neither Micro-F nor Kamurj had accounting systems that interfaced with the MIS. In the interim, until the merged organization could identify a better system, it adopted Micro-F's accounting system and commissioned the Finance and Accounting Project Team to investigate how to make the switch and to create new receipt forms and other paper documentation as needed. The team compared redundant forms from both organizations and then created a new format using the best features of each. As soon as the new format was reviewed and approved by management, it was adopted.

### **Internal Control, Monitoring**

One of the adverse effects of the merger in Armenia was an immediate jump in staff and portfolio without an accompanying internal control system in place. Post-merger integration left policies and procedures in flux and the door open to misinterpretation or misunderstanding of new policies. Tight monitoring practices were loosened as attention was pulled from operations in order to focus on merger integration.

Without a tight MIS, clearly written and communicated policies and procedures, and an adequate accounting system, the merged organization will face serious control problems that leave it vulnerable to innocent mistakes at best and fraud and mismanagement at worst. This was exactly what we faced in Armenia, just three months after the official merger date, when we discovered our first case of fraud.

### **The Gyumri Branch Fraud Case**

The Gyumri Branch was one of CRS Kamurj Program's most successful branches from the very start of operations. With a team of six loan staff, one of whom was later promoted to branch manager, the branch reached 1,000 clients in seven months and maintained less than 1 percent portfolio at risk. At the time of the merger, which necessitated a convergence of CRS's village banking and SC's solidarity lending methodologies, several policies were altered, and the following changes were gradually made:

1. Under CRS, community banks kept an internal account within the group. Unused funds (not disbursed in internal account loans) were kept by the group treasurer. Under the new MDF Kamurj policy, internal account funds were transferred to a group reserve fund and kept in the office for better security. This change was instituted gradually, and it was left up to the group to decide whether to implement it mid-cycle. In subsequent cycles, groups were required to make a reserve deposit only, with the receipt provided by the branch accountant.
2. Under CRS, group meetings were held in the office with the promoter, then repayments were taken to the bank by the group treasurer. After the merger, groups were given the opportunity to meet either in or outside the office, and the group treasurer would bring the payment to the office. The accountant accepted the money, then deposited it in the bank if the amount of cash exceeded a certain figure. This procedure was designed to make repayments more convenient for clients, since the bank did not provide very good service.
3. A seasonal loan product, supplemental to group "standard" loans, was introduced in November, shortly after the assets transfer of the merger. This increased the workload of promoters and also added to the changes that staff had to get used to implementing.

On top of all of these changes, the continued rapid growth of the Gyumri branch to meet the town's huge demand heightened

the potential for lapses in control. Unfortunately, it was not until the end of December 2000, when seasonal loans were due and delinquency rose rapidly in one loan promoter's portfolio, that the fraud was discovered. The problems began to spread to standard loans within the promoter's portfolio as well. When management, along with the other promoters and the branch manager, began to investigate the problems, they discovered:

- The loan promoter had given loans to a few of his friends (men) through fake groups of 15-20 women clients. (MDF Kamurj serves only women.)
- Some clients who wished to sit out a cycle and then rejoin colluded with the promoter to take a second loan, give their loans to outside people (men), and then plan to rejoin in the third cycle so that they could get the third-cycle maximum loan size.
- In addition to standard loans, the promoter gave seasonal loans to friends in the same fake groups.
- During the period of change where internal account funds were being transferred from groups to the office for safe-keeping, the promoter himself took savings from several groups supposedly to deposit in the office; but this money was unaccounted for.
- The promoter used group repayments from some legitimate groups to repay fake groups' delinquent loans.
- The loan promoter added 4-5 new members to his existing groups when they passed to the next cycle, promising his groups that these were good clients and would repay, in order to increase his number of active clients and qualify for higher incentives.
- The promoter signed his own loan applications for groups when the branch manager was out of the country for a training. (He was placed second in command of the office during this time.)

In brief, the loan promoter engaged in a number of policy violations that, under normal circumstances, might have been detected much earlier. But because many policies were still new, and were announced over the course of several memos, staff were easily confused. The increased stress and workload during the integration period also drew attention away from close monitoring.

Fortunately, a quick response and tough action on the part of management brought the situation to quick resolution, with 100 percent of the funds (roughly equal to \$9,000) returned and without a court case. But this case constituted a significant setback, stole time away from the merger integration process, and placed even more strain on management and staff.



## **EXPERIENCE**

### **The Complications of Multiple Merger Partners During Integration: The Experience of Eco Futuro in Bolivia**

Several merger cases presented at the end of this book highlight the added difficulty involved when not two but several NGOs are integrating their operations. At Eco Futuro in Bolivia, the merger involved four NGOs that had to be equally proactive, willing to turn the lead role over to a third-party manager, and able to coordinate their own planning and projections during the transition period for a smooth transfer of operations to the new entity—all without upsetting operations or adversely affecting repayment quality. According to former Eco Futuro General Manager Gonzalo Puente, the roles that each NGO would play were not always clearly defined, and this made relations between the NGOs and the new management difficult and tense at times. Some of his recommendations for smoother integration can be summarized as follows:

- Plan the integration process, especially portfolio transfer, carefully. This requires a well-defined business plan for each NGO partner that will continue to exist beyond the merger, and a clear plan for how it will assume its new role. In Eco Futuro's case, some NGOs began to renege on their commitments, continuing to operate as microcredit lending NGOs in direct competition with Eco Futuro.

- Agree on timing with each partner, and plan to complete the transfer in the shortest term possible. Several NGOs chose to modify a previously agreed date, and this had to be managed carefully, taking into consideration that no merging NGO could stop lending operations in one day, and different NGOs would be ready to complete the transfer at different times.
- Rather than waiting until the portfolios are transferred to the new entity, there should be prior standardization of the NGO programs, with the NGOs extending new loans under the terms defined by the merged entity. Unfortunately, during the Eco Futuro merger process, the NGOs did not want to undergo this standardization process, which would have made the transfer easier and more gradual for both Eco Futuro and its clients.
- The introduction of the new entity in the markets, even if announced beforehand as part of the entry strategy, must be handled carefully. The slightest perception by clients that the former entity will no longer be present can produce defaults or client dropouts that are difficult and costly to correct. In the Eco Futuro case, as soon as they perceived that the NGO would no longer be operating, clients—especially those in the rural areas—assumed that they were no longer in debt to the NGO. In response, Eco Futuro posted a sign that displayed both its name and the name of the NGO, stressing that Eco Futuro was the "new name" of the former NGO but that the current credit terms, personnel, and so on would remain the same.<sup>80</sup> ■

## Filing System

A filing system may not seem like a priority issue for a merger integration checklist, but it should not be overlooked. Trying to monitor the merger integration process and internally audit branch operations when every branch still has its own way of organizing information can be extremely difficult. Developing a standard procedure for naming documents and files, keeping personnel files

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<sup>80</sup> Gonzalo Puente, "NGO Mergers to Create a Single Regulated Microfinance Entity: The Experience of Eco Futuro SA FFP Bolivian Private Financial Fund." Presented at the IV Inter-American Microenterprise Forum (panel discussion on "Merging: Experiences in Microfinance Institutions"), Santo Domingo, Dominican Republic, November 14-16, 2001. (Translation arranged by CRS Peru.)

secure and in order, and making sure all documentation is collected for loan applications and loan contracts is essential to a smooth integration process and careful monitoring and control.

### **Impact Monitoring System**

SC's Micro-F had been collecting socio-economic data on every client with each loan application to monitor trends in family income levels, job creation, and business growth. It had developed a few donor reports that analyzed these trends, but the increasing amount of information collected was proving unwieldy and burdensome. CRS's Kamurj program had relied only on periodic client satisfaction surveys that were intended less for tracking business sales or growth in income than for measuring client satisfaction with services. Neither database was very user-friendly, nor was the information easy to retrieve and analyze. Plans for developing a better system were included in the merger integration. But with so many other pressing issues at hand, they were later put on the back burner. The justification was that if the donor didn't specifically ask for impact monitoring, we wouldn't worry about it. Impact monitoring in general is a contested topic within the microfinance community. Moreover, collecting and analyzing data when we could little afford the time involved and could not guarantee its complete accuracy was simply not worthwhile. Instead, we focused on other ways to seek client feedback and gauge client satisfaction. We stressed these matters in every training to every staff person at every level; we developed short client surveys and suggestion boxes; and we held periodic focus groups to get verbal feedback from clients and the loan officers who saw them every day. In a highly educated society with savvy businesswomen and plenty of other competitors out there, we determined that client satisfaction was a sufficient reflection of impact: when clients returned for repeat loans, we assumed they found the product beneficial.

## TIPS

**Determine well in advance of post-merger integration how you will maintain internal controls, and put key points in writing for all staff.** Think ahead about the crucial procedures that need to get underway and be monitored—such as handling cash and receipts, and scheduling minimum monitoring visits by managers or internal auditors.

**Don't tinker with lending policies and procedures until you have clearly developed replacements for them and simple, written, well-communicated instructions.** Don't start making changes until you have thought this process through. Confusion and misinterpretation are bound to arise in any merger; but you can minimize them by setting new procedures down on paper and communicating them clearly to every staff member before beginning to implement them. Always follow up written memoranda with an explanation in person to confirm that the information is received and understood.

**Stay involved in daily operations.** Often in small-scale MFIs, the founding director sets the tone and is integrally involved in daily operations. When this hands-on approach is diluted by the addition of other branches and staff, and when at least one side of the merger experiences a change in management, a more relaxed atmosphere can result that may leave room for employees to interpret correct and ethical behavior individually. It's easy to turn inward and focus on the integration process, but management must continue to make field visits and keep an eye on operations, if only to let staff know that someone is still watching. The point is not to "catch them in the act," but to let employees know that you are in touch with them and care about what is happening on the ground.

**Make sure every staff member has a copy of the organizational chart, in which monitoring, reporting, and channels of communication are well defined.** In addition to detailing top management's close involvement in the process, there should be clearly defined monitoring and supervisory roles for middle managers and key people whom staff know to ask when they have questions about changes in policies or procedures. ■

In sum, post-merger integration doesn't have to be bad. As Galpin and Herndon note in their *Complete Guide to Mergers and Acquisitions*, integration can actually reinforce strengths and offset weaknesses, improve efficiency, reduce redundancy, and create a sense of shared purpose for everyone in the newly combined organization. This helps employees embrace the change rather than resist it. But the entire organization must be involved—not just one unit or one level.<sup>81</sup>

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<sup>81</sup> Timothy J. Galpin, and Mark Herndon. *The Complete Guide to Mergers and Acquisitions: Process Tools to Support M&A Integration at Every Level*, San Francisco: Jossey-Bass Publishers, Inc., 2000, p. 646.

# Chapter Ten

## Summary and Conclusions

There is no secret ingredient that can ensure a successful merger. Much depends on how events unfold, and above all on those individuals who, by chance or circumstance, are drawn into the process and learn together how to implement and adapt to the change.

The merger experiences in Armenia and the other examples<sup>82</sup> yielded more lessons than can be captured here; the following summary of key points presents the most important lessons in hope that they will be useful for future microfinance mergers.

### Ten Lessons For Mergers

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#### 1. Stay True to Mission, Never Lose Sight of Vision

In the microfinance formalization debate, there has been much talk about "mission creep" and the risk that an NGO's social purpose will be lost in the change to a regulated, formal financial institution. For NGOs considering or involved in mergers, mission should be no less central a focus: the merging parties must share not only a common notion of the mission of the merged entity, but also a common vision for what they intend the merger to accomplish.

The wish to remain true to its mission was the principle reason that the CRECER program of Freedom from Hunger decided against a merger in Bolivia. Likewise, fear of losing its mission was a key factor in FIE's decision to back out of its planned merger with

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<sup>82</sup> For detailed information about these case studies see the companion resource: McCarter, *Microfinance Mergers: Twelve Case Studies*.

PRODEM. Mission was also at the forefront of discussions in the Philippines over the creation of the Opportunity Microfinance Bank as a regulated, microfinance-oriented thrift bank.

In Armenia, what kept negotiations on track and helped the parties involved overcome the obstacles they encountered was their constant *focus on their mission* and their *confidence that that mission was shared by everyone*. Without this focus and confidence, conflicts over turf, control, and claiming credit could have derailed the whole process.

## **2. Build Trust—Before, During, and After**

The issue of trust comes up repeatedly in this book; the *crucial importance of establishing a foundation of trust* for mergers to succeed cannot be overemphasized.

Building trust is not easy; it requires ample time and a willingness to take some chances. There is no way to guarantee a perfect due diligence report, a perfect selection process for new management, a perfect transition and integration process; ultimately, once they have done everything they can to ensure the quality of these processes, the people involved in the merger must give up control and trust each other. To help build trust:

- Find a neutral, trusted person to help you broker the deal
- Meet merger partners face to face
- Spend time getting to know each other informally
- Disclose potential obstacles early on to avoid surprises later
- Openly discuss how the merger will affect those involved—staff, management, board, donors—to avoid sabotage caused by insecurity and fear of change
- Agree to confer before making major decisions
- Be willing to collaborate daily and share information
- Maintain constant and open communication with all players
- Address questions and concerns as they arise, without delay

## **3. Get Buy-in at Every Level**

Every person involved in the merger process, from donors,

investors and board members to top executives, middle managers and loan staff, should buy-in to the merger idea.

How can this be accomplished? At OMB in the Philippines, it required the commitment and perseverance of those initially in favor of the merger to persuade those who were more resistant. At Enlace in El Salvador, getting buy-in was a major pitfall of the portfolio purchase scheme, as the design made sense but the NGOs were more interested in their own survival and did not accept the merger idea in the end. Likewise, at Eco Futuro in Bolivia, some of the NGOs agreed initially to the merger but then refused to give up control over their portfolios afterward.

Each of these cases backs up Armenia's own experience, where buy-in was a central focus at every point in the merger process and required:

- knowing ahead of time a resister's agenda and what s/he wanted or feared from a merger
- approaching every resister with a strategy in mind to sell the idea
- leading by example (commitment and exuberance breed the same)
- providing constant assurance and encouragement, especially for employees.

#### **4. Find a Leader**

Leadership is critical both for the early stages of negotiating the merger and for its successful implementation. To fully seize the opportunity the merger presents, you need people with the skills and the common will to make it a success. Especially for mergers that involve setting up a regulated entity, the leader must also have the professional experience that the job demands.

The Financiera Confia and Eco Futuro cases both underscore the need to choose professionals with experience from the business, not NGO, community to efficiently manage a regulated entity.

The Armenia experience proved that success depends on someone with both management and leadership skills. What this boils down to is someone who is:

- visionary
- courageous and willing to take risks
- able to cope with change and help others do the same
- able to put the organization's interests ahead of his/her own
- able to manage personalities and staff relationships
- able to make strong, fair judgments
- able to listen and stay calm

It was not only the local leadership that made the Armenia merger a success, but also the key figures at the international organizations' headquarters who had the influence and the daring to push ahead. A merger's impact reverberates through an entire organization, requiring an internal advocate who can do the "path clearing" and form relationships, negotiate, and encourage new ways of thinking beyond the traditional development mindset. Without someone in this position, the merger idea may die before it ever gets off the ground.

## **5. Be Realistic**

The amount of time, energy, and work needed to implement a merger can come as an unpleasant surprise. It involves running two or more businesses while planning for and managing a merger at the same time. Depending on the type of merger, it also means handling a number of processes simultaneously: merging, separating from another NGO (as in the case of Armenia), registering a new similar legal entity or establishing a different legal entity (regulated), and professionalizing services accordingly.

Finally, it means being willing to face the reality that the merger will require you to:

- Treat the merger as a separate project in itself, a third business that you have to set up while running your own.
- Hire someone—from an external source if possible—specifically to help you with this mammoth task, such as an integration core team leader. Relying only on your own personnel will result in managers and staff who are overworked and overstressed. Outsiders can be very useful

as long as they are experienced and effective, and bring a neutral balance to the process.

- Establish realistic expectations and a timeline that you can actually stick to (but be ambitious enough to push the process through as quickly as possible).
- Expect to increase your budget to cover the short-term costs associated with the merger.

## **6. Be Prepared**

The merger process is rarely smooth, but it can be made much easier with appropriate, well thought-out plans. At a minimum, make sure you develop a detailed Strategic Plan and a Transition Plan, using examples from this or other available books on M&A.

During the planning process:

- Early on, develop a checklist of issues to address, and prioritize them.
- Try to predict sticking points and obstacles.
- Define roles and responsibilities from the outset.
- Define clear procedures for implementing decisions.
- Keep the strategic plan brief and concise.
- Begin planning the transition long before the deal is signed.
- Involve task force teams in planning to ensure accountability during the implementation phase.

## **7. Be Extra Sensitive to Culture—Before, During, and After**

Cultural and human-related issues can threaten to undermine a merger at every stage. Indeed, cultural challenges arose in 11 out of the 12 other microfinance merger case examples presented in the companion resource.<sup>83</sup> It is impossible to avoid cultural clashes; the key is to know how to manage them.

- Be sensitive to the fact that one side will bear the greater burden of change.

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<sup>83</sup> *Ibid.*

- Identify cultural differences early on and don't be afraid to speak openly about them.
- Develop a plan to implement cultural integration.
- Don't let one bad apple spoil the whole bunch—be willing to fire those who don't support merger goals.
- Hold social events, repeatedly.
- Be patient and give the cultural integration process time.
- Remain focused on where you are going, not where you have been.
- Provide strong leadership—this means setting the right tone, rewarding tolerance and compromise, and penalizing those who show a lack of professionalism.

## **8. Communicate, Constantly**

A key element of managing the merger process is communication. Communication builds trust, ensures buy-in, and lets everyone know what is happening and what to expect to avoid the fear, uncertainty and doubt (FUD) among employees that can breed rumors and misinformation. It is important to communicate things such as mission and vision; the rationale for the merger; the merger plan; how jobs and other sensitive issues will be affected; and most important, positive excitement about the merger.

It's important not only *what* you communicate, but also *how* and to *whom* you communicate:

- Use a variety of means to communicate—through social events, frequent e-mail updates, staff meetings, one-on-one interactions, and *leading by example*.
- Identify an accessible key person responsible for communication so everyone knows whom to ask when they have questions.
- Decide when and to whom you should communicate, and plan your strategy accordingly: this includes communication not only to employees but also to clients, regulators, the media, and any others who can help or hinder the process.

## 9. Find a Neutral Outsider to Help

Outsiders can bring objectivity and balance to what is often a very emotional process for the staff involved. That said, the outsider *must be perceived as a neutral and objective actor* in the process. Otherwise s/he will have no credibility and will only harm the process.

Using an outsider can be extremely useful at several stages during a merger:

- First approach: A known, trusted outsider with both organizations' best interests in mind can skillfully play matchmaker.
- Negotiations and planning: When crucial and controversial decisions are being made, an outsider with experience, expertise, and objectivity will help move things along and keep the merger process on track.
- Integration: An outsider can help avoid staff overload during the complex and demanding integration process. At a minimum, it is important to designate a person or a core team of people who will devote 100 percent of their time to advancing the merger process and keeping people and deadlines on track.

## 10. Maintain Momentum, and Persevere

No matter how realistic or well-prepared you think you are, there will be unexpected obstacles, delays, and surprises along the way. Sometimes momentum is everything: if you move too slowly, allow morale to slip, and let the process stall, the merger can derail entirely.

Keys to success in the Armenia merger were people's capacity to be flexible, respond quickly, maintain a sense of humor, and constantly push through to the end. Other practitioners' tips for maintaining momentum include:

- Take steps one at a time and in order (Financiera Confia)
- Keep your time frame tight (FORA Fund)
- Pursue any opportunity to speed up the consolidation process (OMB)

- Once the decision is made, complete the process as quickly as possible before any information leaks to the outside, or you may lose valuable or critical employees (Financiera El Comercio)

Finally, consider Grubb's and Lamb's "fast-track integration," where you start with an action plan designed to achieve three "easy wins" in the first six months. When integration gets off to a good start, the high morale alone will add to momentum.

## Learning from Success...and Failure

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Was the merger in Armenia a success? Although the story is still unfolding, the statistics and comments from the field indicate that so far, MDF Kamurj has achieved what it set out to do. As of December 2001, just over one year after the official merger date, MDF Kamurj was serving 5,895 active clients, with \$1,140,000 loans outstanding and 1.66 percent portfolio at risk (more than one day). It has expanded its product range to include seasonal loans and higher-end loans, and is preparing to offer individual loans to long-time members. According to Executive Director Gagik Vardanyan, "We have managed to overcome those early hurdles, diversify and expand our services, strengthen our position in the country, and even generate interest from other donors and programs in Armenia who might team up with us. The psychological differences between the two sides of staff finally disappeared as MDF management proved by its actions that it would follow the values and principles, and especially human resource policies, we developed together during the merger negotiations. I think we have built a solid base and a solid team now."<sup>84</sup>

There are also positive reports of success from other microfinance mergers nearing completion, such as those in Russia, the Philippines, Palestine, and Paraguay. However, just as important are the two merger "failures" presented in this book—cases that demonstrate that even when a particular merger fails, those involved often remain convinced of the benefits of mergers in general. For example, those involved in both the PRODEM-FIE and

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<sup>84</sup> Correspondence with Gagik Vardanyan, MDF Kamurj Executive Director, January 2002, [vgagik@arminco.com](mailto:vgagik@arminco.com).

Eco Futuro cases were still extremely positive about the potential for mergers in the microfinance industry.

Gonzalo Puente, the former General Manager of Eco Futuro, captured the sentiment exactly:

I would gladly face another merger...because I am convinced that mergers bring more advantages than disadvantages. When the players and management can stay focused on these positive factors throughout the entire planning and integration process, I am sure that disadvantages can be controlled and avoided in most cases. *But it requires an ability to take into account lessons learned from others' experiences, a respect for the complexity of problems that can occur, and an acceptance of the reality of a long and arduous process to make the merger a success.*<sup>85</sup> (Italics added by author.)

This set of tools based on the Armenia experience adds to a growing body of knowledge among practitioners and indicates that mergers may well be the wave of the future for the microfinance industry, as it searches for new ways to expand outreach and better serve the needs of microentrepreneurs around the world.

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<sup>85</sup> Gonzalo Puente, "NGO Mergers to Create a Single Regulated Microfinance Entity: The Experience of Eco Future SA FFP Bolivian Private Financial Fund." Presented at the IV Inter-American Microenterprise Forum (panel discussion on "Merging: Experiences in Microfinance Institutions"), Santo Domingo, Dominican Republic, November 14-16, 2001. (Translation arranged by CRS Peru.)

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## About the Author

Elissa McCarter has worked for Catholic Relief Services since 1998. She launched the CRS Kamurj Microfinance Program in Armenia and has provided technical assistance to other partner organizations in Armenia and Zimbabwe. Before joining CRS, she worked with women's self-help groups in Benin and served as a public school teacher in France, where her passion for teaching and training first emerged. She has facilitated workshops in *Business Planning for Microfinance*, *Managing Growth*, *Market Research and Product Design*, *Delinquency Prevention*, and *Training of Trainers*. She is a graduate of Vanderbilt University and has a Master's Degree in International Development from Georgetown University's School of Foreign Service. She currently lives in Istanbul, Turkey, where she serves as a technical advisor to a local women's NGO that is establishing the country's first microfinance institution.