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Session 78IF
How to Avoid Common Pitfalls of Health Plan Mergers

Track: Health

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Panel: LINDA BRONSTEIN
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BARBARA MCNAMARA[H]
Recorder: WILLIAM E. ROCKWELL

Summary: Panelists discuss common problems in creating a successful merger and why a merger might not accomplish the intended outcome. Some of these problems include:
- *Culture clashes*
- *Handling physician employees*
- *Not incorporating community support*
- *Current management*
- *Not achieving economies of scale*
- *Improper communications*

Session attendees have the opportunity to share their experiences with hurdles to accomplishing a successful merger.

Ms. Alice Rosenblatt: I'm responsible for Merger and Acquisition Integration at WellPoint Health Networks, and I also serve as the chief actuary. Last week, I met with a consultant who specializes in mergers and acquisitions. This particular consultant told me something that I have to share in my presentation.
This consultant told me that there are two kinds of companies. The first kind of company is one that has made a lot of mistakes doing mergers and acquisitions and has learned from those mistakes. The second type is the company that hasn't made any mistakes yet because they haven't done any mergers or acquisitions yet. So I'm not sure you're really going to walk away from here knowing how to avoid all the pitfalls, but we are going to give you some lessons we have learned.

I'm going to introduce our three speakers. Each speaker is going to share a case study based on real life experience in the merger and acquisition (M&A) area and

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Note: The chart referred to in text can be found at the end of the manuscript.

[H]Ms. McNamara, not a member of the sponsoring organizations, is Vice President of Human Resources at Wellpoint Health Networks in Thousand Oaks, CA.

give you some lessons learned. Then we are hoping to have a lot of interaction from the audience, who can share some war stories.
Our first speaker will be Linda Bronstein. Linda is the chief actuary for Anthem Blue Cross and Blue Shield of the Midwest. She has a lot of experience in data warehouses, and in 1996, she co-authored an article that is included in a book titled, *Building a Data Warehouse for Decision Support* by Vidette Poe. Linda will speak on consolidating performance measurement functions.

The following speaker will be Pennell Hamilton. Pennell is currently the senior vice president and eastern division CFO for Foundation Health Systems. He's responsible for accounting, accounts receivable, financial reporting and analysis, underwriting, purchasing and facilities for the division. Pennell will be presenting a case study on the consolidation of MD Health Plans, Physicians' Health Service, and First Option Health Plan, into the Northeast Division of Foundation Health Systems.

Our final speaker will be Barbara McNamara from WellPoint Health Networks. Barbara is not an actuary; she is vice president of employment and employee relations at WellPoint. That's human resources. She and I work together closely on integration activities. Barbara will be sharing some of WellPoint's experiences with our recent acquisition of the Rush Prudential Health Plan in Chicago, which is now known as UNICARE Health Plans.

Our recorder today will be Bill Rockwell. Bill is also from WellPoint Health Networks and works in the corporate actuarial area.

As you listen to the speakers, you will hear some common themes, such as the importance of communication and understanding cultural differences.

Ms. Linda Bronstein: Let's start with some surveys to see exactly how many have been involved in mergers and war stories. How many of you have been involved in mergers of companies? There should be some good war stories. How many have been involved in mergers of departments and various units within just one company? I've been involved in both. I think there are many similarities, and as we go through my case example, you'll hopefully relate to a few of them. I want to share some of the pitfalls on the people and organizational management side of mergers, rather than focusing on the pitfalls of the direct number value expectations side.

As actuaries, we're often comfortable when dealing with numbers; however, you will find that we tend not to realize the expected dollar value out of a merger unless we recognize and pay attention to the people side.

The one thing I've learned, and I think you recognize, is that it takes very committed people working together to make a merger successful. The best description I've found on commitment is the example of the teamwork of the chicken and the pig to make breakfast. The chicken is interested and the pig is committed. In fact, there's no turning back for the pig. Mergers need to be approached with the aspect of no turning back. A no–turning- back attitude needs

to exist in the entire organization. That has been the case of the mergers of departments and units and the mergers of companies that I've been involved in. I work for Anthem Blue Cross and Blue Shield. It's formed by the merger and acquisition of Blue Cross and Blue Shield license companies that are located in Indiana, Kentucky, Ohio, Colorado, Connecticut, Nevada, and New Hampshire. Currently, there is about $8 billion in annual revenue, and we provide health plans that cover approximately 6.5 million members. Anthem is organized into regional business units. I will be addressing three critical success factors related to my experiences and lessons learned in consolidating all of the performance management reporting functions within the Anthem Midwest Region, which is Ohio, Indiana, and Kentucky. It covers about four million members.

There are three factors I will be talking about that need to be considered in order to have a successful merger. Pennell and Barbara will be covering more, because these are not the only factors. There are many war stories and a lot of things that need to be paid attention to and to work well for a successful merger.

The ones I will be focusing on are related to the people side. The three factors you need to create a successful merger are: a well-planned and executed communications strategy, a fostering of corporate citizenship, and a focus on the human factor.

The first critical success factor is a well-planned and executed communication strategy. Communications should be frequent and candid. Even when information is unknown, the communication should inform people when something isn't known or a decision hasn't been made. The communication effort should be focused on who the audience is. I think something very important to remember is the underlying question that everyone involved in a merger has: "What does it mean to me?" So focus on your audience and try to always keep that question in mind and tailor your communications to try to answer that question. Don't be afraid to be redundant in your communications. State the message simply, confidently, and frequently.

The second critical success factor is having resources focused on promoting and fostering corporate citizenship and cultural issues. You need to foster the loyalty, effectiveness, and efficiencies needed to maintain the current business, as well as to provide a foundation for change that will be needed to develop a successful merged company.

The third critical factor is addressing the human factors. Focus on minimizing stress and anxiety. You have to keep the current business going and people can spend a lot of time dealing with stress, anxiety, the water fountain syndrome, and so on. Remember that worrying about the unknown causes stress; therefore, communication often needs to be about what is known, what decisions have been made, what will it mean to people, what decisions are yet to be made. Focus on offering training for the newly needed skill-sets. Key training areas include material on mergers and change management. Create aligned incentives for all associates within the organization.

The experience in mergers that I'm sharing with you is to show some of the ways these factors impacted and were addressed in the consolidation of the performance management reporting functions into one division within Anthem Midwest. I'll give background information on the purpose, scope, project team, and plan from the gap analysis to the actual implementation. I'll summarize the results and some lessons learned with respect to the three success factors.

The purpose was clearly defined when the Anthem Midwest senior management team announced that the performance management reporting functions would be consolidated into one division to ensure the accuracy, consistency, and efficiency in reporting analysis and interpretation of data. The goal was to get various merging entities on a same language basis, with respect to data interpretation and analysis. In total, there were 75 associates in eight legal entities and different management structures. They were located in five cities, doing 14 different reporting functions. The functions included account reporting, product profitability, provider network reporting, trend reporting, geo-access reports, and what is often considered as business management reporting.

A 15-associate project team was formed from the 75 total associates to represent each function and location. A communication plan was laid out to keep the 75 associates and their current management and clients aware of the progress and results that were occurring during the development of the new organizational structure. One of the key events was fondly called, "Hell-o Week." The project team members dedicated an entire week to assimilating the information they had gathered during the gap analysis and developing the go-forward accountabilities, deliverables, and organizational plans. It took about 1,700 hours over a period of three calendar months to assess, develop, and implement a new organizational structure, while still maintaining the ongoing business reporting functions for all of the entities and blocks of business.

A gap analysis was performed to assess the current capabilities, deliverables, and deficiencies. Client interviews and surveys described an insular reporting environment characterized by pockets of expertise that were scattered geographically among various legal entities, management entities, and structures. Each had differing priorities placed on standardization and a leveraging of corporate resources.

Earlier I'd mentioned the key event of "Hell-o Week." It was given this name because the project team had committed to not leaving for the weekend until they agreed on an organizational design for a consolidated unit positioned to provide the Midwest their current baseline reporting. The team also wanted to be well positioned to develop new and enhanced reporting capabilities to meet the increasing demands for information needed to manage the Midwest consolidated merged company.

The implementation included steps for defining job descriptions and accountabilities in the new organizational structure, a communication plan for organization design,

and interviewing and filling positions and communicating to all associates to start and take on their new roles. The resulting consolidated organization is now functionally aligned. A team was created to do core reporting development needed to move our organization forward and get us all on one page.

A new role of a client consultant was created to address cross-functional needs and to ensure fulfillment of client reporting needs. There was major concern throughout the organization about the prior management and business areas. They were going to lose information and not be able to manage their businesses. We developed the client consultant role as a direct result of these concerns.

Performance management staff recognized and accepted they would be geographically challenged. They would be one team, spread across multiple locations. Management was by function, and not by physical location.

The functionally aligned model comprised four major groupings of reporting accountabilities to produce the current business reporting and to develop consistent reporting requirements for the Midwest. The frontline, ongoing business management reporting is keeping track of the ongoing business. The core development team is developing the more complex applications to meet consistent reporting requirements. The associates are located in four cities, and again, deal with the aspect of being geographically challenged. Lessons were learned and war stories came about.

First, we had a good project plan. We're glad that we did. It kept us on track so that we didn't overlook anything. That's not to say it was smooth sailing. There were some bumpy roads. I would say one of the most important things is that we had the support to develop a good plan from a resource out of human resources. We had someone who had been involved in the merger of various companies and business units. He brought his lessons learned and war stories that I think helped us avoid some of our own. That's one thing to consider when you're going through mergers. Has somebody been there, done that, and do they have their own war stories to bring to the table?

The cross-functional cross-location project team ensured that all associates had representatives. This was someone to whom they could provide input for the development of the plan, as well as someone who could provide them more personal communication about progress. The representation by location on the team that was developing the go-forward plan really helped to keep all associates informed. They knew pretty much day-to-day from their project team representative about the progress that day, and when people in that location had concerns, the project team was getting good feedback.

This helped to get the best model set up because we had a lot of good input coming from all locations and all functions, and it helped with the buy-in and the commitment to make the new organizational design a success. There were 22 formal communications that went out to management and associates, plus the various informal ones from the 15 project team managers. I would say more is

definitely better. Some of the feedback we received afterwards indicated that even though we had issued 22 structured communications, more would have been better. Unbelievably, over the three calendar months, we were at the rate of about one or more formal communications a week. Associates thought they were able to provide good input, and the current management structure felt the same way. They could voice concerns to the project team representatives on the various issues and upcoming decisions. Again, we felt it worked well, but there was certainly feedback that communication was critical and could have been improved in a few areas.

The multi-location, multi-function model is now working very well. We were glad we did it. Initially, it was a struggle but it helped make sure we had client focus, which could have been difficult with the many locations, various legal entities and management structures. More importantly, I would say that we were pleased with the fact that we were able to make this happen while minimizing relocation and the disruption to the associates' home life. This helped with the aspect of mitigating the stress and anxiety of going through a merger of multiple companies to make one organization.

The one struggle that we've had is learning to live in a geographically challenged work environment. Don't underestimate the need for good training in management and communication skills when you're working with multiple locations. Also make sure you've implemented enabling tools. Make sure that your information technology area is there with a local area network, a wide area network, and the Internet capabilities for your group to be able to work in a multi-location environment. Make sure all associates are trained to effectively use those tools.

In conclusion, when you're going to be involved in a merger, be sure to consider and address these three factors. first, have a well-planned communication strategy. Second, resources should b e focused on that corporate citizenship, (remember you have to keep the current business if you are going to be able to maintain and deliver the expected value). Finally, focus on the human side. It's the people who are actually going to make this all happen and deliver the value. So I think that those are important from a merger perspective.

I have described some of my experiences. We will take questions and have a discussion period at the end of the presentation. I will turn it over to Pennell.

Mr. Pennell W. Hamilton: It's appropriate that we're in Las Vegas discussing mergers and acquisitions, not just because it's a chancy enterprise. While playing craps, I considered how a merger is a lot like the game of craps. You're in a windowless room, you don't know whether it's day or night, there are no clocks on the wall, there's noise all around you, you're at a table with a seemingly complicated layout, but really a very simple underlying game. Everyone's yelling at you to go. All your years of training tell you the hard-way bet is 14% in favor of the house. You know this fact, and you do it anyway.

I was going to subtitle this one, "Good people make stupid decisions based on numbers." I think the psychological aspects are really what's critical here and more subtle than one usually thinks. We'll also delve into the numbers a little bit,

I want to make two disclaimers up front. Hindsight is a great thing, and doing a presentation like this makes it easy to sound like your company did everything perfectly. Trust me, we messed up plenty. That's why we had the problems. Second, hindsight makes it sound like I think that if only they'd listened to me, everything would have been fine. But again, I figured this out on the back end, and not on the front end.

I want to try to accomplish several things today. The first has to do with using a case study. I'll go over the background briefly. I want to explore what I've identified as four common problems in mergers. Undoubtedly, there are more problems, but I try to pick issues that I've not only noticed in the company I work for, but that I've seen exhibited in other companies.

The first step in figuring out any program of recovery is to recognize you have a problem. Second, I want to explore why they occur, and I think this is a little subtler. The first reaction you might have when you see some of this stuff is to ask, how could they be so stupid? But I think you have to begin to get down to root causes. I sort of look at the total quality management (TQM) part. There are five whys. The real answer is never quite so obvious. Finally, I want to suggest some solutions, which is where the hindsight comes in great. By the way, identifying solutions is easy, but I think when you think about some of these things, actually implementing them is difficult.

I want to give a brief background of the companies. I was brought in to do the financial side of merging three entities in the Northeast Region for Foundation Health Plan. By the way, all of these had one common link; they were based on the dream. What I call the dream is when a group of providers got together and I think, over a few beers, decided if only we could do the financing and manage care, we'd do it better. Of course, they couldn't, which is why they're all owned by another company now.

The first one was MD Health Plans, which is a Connecticut-based company. It had 208,000 members and about $8.6 million of revenue in 1997. If you actually figured the installment provider group they had, there were actually negative earnings, but we'll leave it at $8.6 million. It was provider-started, it was very physician-oriented, and their strategy was to provide the maximum flexibility to the physicians.

Physician Health Services (PHS) which was one of the acquisitions at the time, had about 522,000 members over three states in the Northeast. It lost about $1.2 million in 1997. It was also provider-started, but had gone public at some point in its history, and its strategy was very employer and customer focused. It was a high customer service company.

Finally, you had First Option Health Plans (FOHP) probably the one we wonder why we had, which had about 266,000 members in New Jersey, and lost about $48.2 million in 1997. The conglomeration of these things was about a million-member plan, with an earnings deficit of about $50 million and an unknown strategy. First Option was very hospital-focused. It was provider-focused, but it was all hospital oriented.

That's the background of where we started. I was brought in to do this, and I did investigate what the earnings were, so I knew going into this that they lost about $48.2 million. My first day on the job I went to the vice president of financial planning, and asked the question I probably should have asked first, "What is the plan for this year?" After I picked him up off the ground from laughing, he told me it was $113 million. That's –$48.2 million to $113 million on one million members. I know you don't have a lot of facts, but who in here thinks that's doable? There are a couple hands in the back. Those would be our prospective CEO's in the crowd.

I know the scale's a little different, but we went to about $80 million in two years, which by the way, is a feat I'm quite proud of, but is nowhere near the breathtaking projection. Let's go back.

The people who came up with this plan were really smart people. The CEO of the company was involved. Nobody in there really believed this plan was viable, yet a bunch of very smart people who are probably just as smart as we are, came up with this plan and believed that it actually could happen. Why? How did this occur?

I'm going to go back to my analogy to the Bay of Pigs invasion. You start with a little thing like this. Let's discuss for a few seconds the ingredients. Now this is what I call the synergy problem. By the way, synergy is a word that should be excised from the English language. I was actually disturbed this morning to find there's a definition of it in the dictionary. Of course, the definition is "a mutually advantageous conjunction or compatibility of distinct business participants or elements." So I'm not really worried about anyone understanding what it means as a result.

We start with a synergy problem. Let's run through the ingredients as shown in Chart 1. You start with an aggressive baseline plan at $48 million. That in and of itself would have been an aggressive plan to reach. It would require having the best premium increases and the lowest possible trend, and a very tight expense budget. Add expense cuts, which is the only short-term controllable number I believe that you have. That leaves the obvious long-term problems, an assumption that the actuaries are being conservative on reserves, and isn't that always the case? An assumption that you can manage better than current management in both the medical management and the general management. The company I was working for had the dream too. We can do medical management better than anyone, and we obviously get a bunch of synergies on that. It also assumed that the current management was bad, which is sort of a dangerous thing to do.

Now any one of these assumptions was, in my opinion, aggressive, but the combination of these things was what my controller always called the sun, the moon, and the stars alignment problem. Let's talk about how somebody came up with this.

I start with the fundamental equation of value in any merger, which is my own equation:

$$PV(A+B)>PV(A) + PV(B).$$

We have the present value of the combination of the two companies, which must be greater than what they are separately. In fact, it has to be greater to take up the amount of money you pay for the company. It better be greater than that or Wall Street's going to kill you.

The stock market knows this formula. If you watch merger announcements, when you see a company's value go down, the stock market does this calculation and realizes it's not going to work. I want to say one thing to the prospective CEO's, which is something I learned in finance class. When the market says one thing and you think another thing, be humble. CEO's should take this to heart. Companies have to find a reason for the merger to satisfy Wall Street. There are several possible reasons. You have economies of scale. An example is Aetna. Combined distribution forces and combined geographies get more mass and your costs go down by some sort of economic formula, but the cost of production increases.

There's vertical integration, when the insurance companies were buying health care facilities to integrate along the supply chain. They don't do that anymore. Time Warner AOL is an example of that. Complimentary resources is defined as when one company has something you don't have and you have something it doesn't have. Maybe they distribute well and you make production better and you put them together and you're a better company. There are finance reasons, tax shields, and so on. The most dangerous assumption, which is often used because these other reasons really don't happen all that often is, "I can manage it better than the current idiots in place." Warren Buffet, I think, once talked about the princess and the frog. When you kiss the frog, it may turn into a prince, but there are many more frogs that are really frogs rather than princes out there, so you really have to be careful with this.

So at the end of the day the CEO has to find a reason for this to work. By the way, I call this the marriage analogy. Just before you get married, and you look into the other person's eyes, you think about all the future possibilities, and then you get married and discover it's really hard work. Mergers really go this way.

First, companies want to sell for a reason. Some companies are on the block because they really have a reason. For instance, they think they need more capital. But a lot of companies want to merge because they're too small and they'll never get bigger or they have some fundamental underlying problem. You've got to remember that. CEO's are compelled by this equation. In other words, they have to find a reason for the merger to satisfy Wall Street. Stock price is the

scorecard. Wall Street understands all this. So they come up with these synergies. And they come up with a plan that sort of justifies it. Once this happens and some smart people in the company start figuring out maybe this isn't going to work, the sale becomes paramount. The company that's selling doesn't want to discourage the buyer. The buyer, at this point, is so committed they have no reason to disbelieve what's going on.

The ugly fact is no matter how smart you are, there's always something you don't know. In our company, it was Medicare, but there are always going to be ugly facts you have to worry about. When the CEO or the senior management of the company has made their intentions plain, people are afraid , or feel it is career limiting, to go against them.

I always think of when I was at Unum and the company changed its name from Union Mutual. I was sitting in a room and they brought in some consultants that were hired for millions of dollars. They put this video together that makes you feel real good. It said we were going to change our name to Unum. Everyone in the room looked at each other and probably thought, where did this come from? It turns out that the CEO was the first person to see this name and he signed off on it. I swear everybody else will think, "Well the CEO signed off on it, so this must be okay."

Let's talk about what we can do. First, I'll talk about rigorous analysis. Too often I see these things done on the back of an envelope. When doing rigorous analysis, you first have to start with a good number. That's rigorous too. Then you have to have a good plan. In other words, it's not enough to say, "We can achieve this." Somebody has to tell you how they are going to achieve it, and you have to believe it's realistic within the timeframes given.

Second, you have to remember the sun, the moon, and the stars never actually align. These events are not perfectly correlated. Many of these different things need the same resources to make things happen. I use a 0.25 factor, and it hasn't proven me wrong. In other words, you add all the stuff up, divide it by four, and the result is not a bad number to put in there.

And finally, I'll mention "speak up..". It's not enough to just say something. You actually have to be heard. Someone once told me you can be dead right. I think this has always been good advice. I think there are some things you have to do. First you have to gain credibility. In other words, you have to know your stuff; your numbers have to be together; people must be willing to listen to you, particularly when you're about to make an unpopular suggestion. You have to understand the politics. I always say that, in my actuarial background, you always want to assume the truth but, the fact of the matter is it is often not the truth. You have to understand the politics of the organization, accept that it's there, and figure out how to get around it. You have to know which battles to fight.

There are some of these battles, in terms of these synergies, that didn't matter. There were some that were very important. You have to pick which ones to deal

with. Finally, you have to know how to compromise. I always figure half of the right answer is better than no right answer.

Now I want to talk about the second problem, which is the integration problem. You merge two companies. You have many different companies coming together with all sorts of different processes. Here are some of the problems you'll face. First, you're going to have multiple business strategies. The companies we merged had three strategies. We had a physician satisfaction strategy, a customer satisfaction strategy, and a hospital satisfaction strategy. Imagine the clash when you want to, say, add prescription drugs at a lower cost to the customers. This is great for the customer, but not so good for the physician. If you haven't picked a business strategy you have a problem. Suppose you want to increase fee schedules to satisfy the physicians. It's good for the physicians, but not so great for the customer.

Second, you have multiple technology platforms and champions. Our company had our AS400 guy, we had our Amisys gal, and we had our HSII personnel. I don't know why anyone would support that system. In fact, they've made their careers on these systems. Their incentive is to do anything possible to keep their system in play. You have multiple processes, which have the same problems as the multiple platforms.

Finally, this leads to an inability to choose because you have 50,000 different options running around and different people supporting each. You have almost no ability to choose. Why does this happen? I contend there are several reasons, and this is where the people side comes in. You have to really think about these.

First is the protection of turf. Ultimately, people feel if their decision isn't picked, then they have lost power. Power ranks big on the scale of what people want. Second is job security. People are worried they can't learn new things, which I never quite understood. Many people feel they can't learn new things, and if their solution isn't picked they won't know what to do and they will be losers. This leads to overanalysis. People desperately want to sabotage the system. It is not hard to discredit a particular solution, by the way. When describing analyses, you can say the results were inconclusive. You can say important questions were not answered or maybe they weren't even asked. Significant avenues of investigation were not followed, and ultimately the writer is biased because he or she wants to protect his or her turf. Of course, the different management philosophies will tend to clash with this also.

So what are some potential solutions? I have two key axioms. One, no decision is a decision for chaos and no decision is a decision. Multiple processes are almost always worse than no process at all. Imagine the effects of multiple processes. Your customers aren't happy; your physicians aren't happy; and your employers aren't happy. The people in the processes generally aren't happy either.

First you must pick a strategy, any strategy. Again, any decision is better than no decision. You want to analyze it, but you've got to pick something. You must pick

a system platform, any platform. A theme will emerge here. No platform is going to be perfect. I can always raise objections to any platform. Remember, I said no decision is worse than any decision. You've got to pick quickly, because there's nothing worse than having your providers and customers all mad at you.

Finally pick a process, any process. Once again, you can see the theme. It's the same as it is for the platform. You need to deliver consistent processes so your customers, employees and employers know how to interact with you. Finally, you've got to take care of the people. There is a basic dignity thing here. For example when we wanted to integrate our finance department in New Jersey, we did the following. We went down nine months ahead of time with a plan for doing it. We notified everybody in the plan. We guaranteed them a job. If they were performing their jobs sufficiently for that nine months, we offered them a retention program. We did all that up front, so we ended up being able to fold up very nicely and move stuff up. Whatever you do, remember what people want and give them that basic thing. Finally, you need to remember nothing is going to be perfect. I guarantee you that no integration, no matter how well you do it, is going to be perfect.

This leads us to the next problem, which I call the reserve problem, which is the actuarial part of this. At some time during every merger I contend the following will happen. You will see your paid claims drop like a rock. What happens when you see that? In scenario one, you can say the following to your CEO: "The merger was a stroke of genius." The synergies were greater than you expected. The income growth is in an upward trend, so it's time to declare victory. Or you can say, "The system and process conversion wasn't quite as clean as we thought it was going to be. The claims department is a bit behind in the backlog. The providers were unused to the new claims systems. Completion factors have not caught up with the new payment patterns. The underlying fundamentals of the business haven't changed. Perhaps it's time to be careful."

In fact, this is the one thing we did right. I remember the day we saw that falling paid claim pattern. During the monthly close, we got together the actuary, the controller, and the financial reporting person. We said, we are about to make the decision that will determine whether we have a job in May. The decision to make was whether to buck the trend and add lots of money to the reserves. This, by the way, is an art. But you've got to be following the numbers.

Why does this happen? First, the synergies get behind at just the exact point that you're having problems with your process. The timing, in my opinion, is exquisite. Aetna, in its merger, had income problems and financial problems.
The market begins to question whether you paid the right price for the acquisition. There is pressure to do something about it. Finally, the box slams shut, the ugly fact comes to light, which was in our case, the fact that we're losing $50 million in Medicare. The block was in terrible shape. One of my first jobs was to tell the CEO about this. So what do you do about it? First, you must make sure you're reporting backlog numbers immediately. In terms of setting reserves, backlog is somewhat problematic, but in terms of figuring out what's going on, it is very

important. It is a number everybody understands. If you're reporting them from day one, when suddenly the claims start dropping, you have a basis for having people understand.

You need to develop a program to measure the impact of synergies. You will make no friends in the organization when you tell them that their share of synergy is not happening as quickly as they expected. But you need to do it. You need to do it from day one. You need to report on it. If you do all this, it's not so much of a surprise when you go and tell people things weren't working quite as well as they expected.

Finally, I want to talk about culture, which is always a difficult thing to do in an actuarial setting. I was actually disappointed to find that there was a definition of culture for corporations in the dictionary, which is, "the set of shared attitudes, values, goals, and practices that characterize a company or corporation." Actually, I thought that was a fairly useful definition. Culture is really all about the unwritten rules. It's about what's not in the rulebook; it's about what's between the white lines on the organizational chart. It is about what you don't know until you've worked in an organization. How is this manifested? It is obviously in different strategies that aren't always stated. It is also in different work environments. For example, there is a company working an individual versus a team environment. Something as simple as what hours do people keep? In other words, in some companies, people come in early and work 7 to 6, and at other companies people come at 9 and work to 9. These changes can create incredible clashes for people that are used to a different way of doing things.

There are the unwritten rules. One of the companies that merged was the MD Health Plans. The way they tended to operate, was when you had a problem, you walked down the hall and poked your head in the office to tell somebody about it. At PHS, when you had a problem, you sent an e-mail. The last line would read, "by the way, if I don't hear from you in two days then I'll assume that you agree with me." This is how these two cultures clash. But this is culture in action.

Finally, there are different management strategies and positioning of the company. How do you position yourself to the outside world? This leads to a lack of teamwork. It is very hard to work together if you don't understand you are working within differing cultures. It will lead, in my contention, to ineffective integration of processes because people are trying to accomplish different things. So why does this happen?

First, when you have to do a merger you have to preserve management. Obviously, the current management doesn't want to get kicked out. In order to make the merger happen you must do something. In our case, you have the CEO and the chief marketing officer from one company, the chief medical officer and the chief operating officer from another company, and never the twain meet.

People are afraid to say there's a winner and a loser. It's difficult to do sometimes. People are worried about keeping their jobs, particularly management people.

Management people can sabotage processes. Finally, I've found management folks tend to be more analytic. They don't respect the people side because understanding the people side is actually hard. It's not like analyzing numbers where you can keep the emotions out of it. It does involve us emotionally, and it is important, so what can we do?

I contend you must first change management. I know sometimes saying a nasty word is important. People will fight back if they're kept in the dark. If people don't know what's happening, how can they execute what you want them to do? Change management can help you with all of these. I believe this is when you should get professionals. This is a difficult subject. You need people to help you who know what they're doing. You have to pick a management. I know this is a hard one too, but one management has to stay and one management probably has to go. It's very hard and almost impossible to integrate management. I guess because I was an outsider I would tell you to get some outsiders. But the advantage of being an outsider or having one or two around is that they can be objective. They can give you some clues on these cultural things because they aren't involved in the middle. They may identify the road you didn't think of because people are only thinking about answers they know about. They can ask a simple question, which is, "Why?"

You have to accept that some conflict is inevitable, and you have to let it happen. But you have to be very careful that you don't get paralyzed in the decision-making because you have to remember no decision is a decision.

Here are some of the takeaways in terms of health plan mergers and what can you do. First, be realistic in your expectations. Rigorously analyze and develop credibility with the organization and get it out early. Make decisions. Do not allow analysis paralysis to set in. Be ready for pressure at exactly the worst time in the process, but make sure you've done your rigorous analysis. Remember nothing happens perfectly. Finally, manage change. I contend that if you don't manage change, then what you'll be managing is chaos. With that, I'll turn it over to Barbara McNamara.

Ms. Barbara McNamara: I'm going to cover a little bit of background on WellPoint and its merger and acquisition strategy and goals. I think a company's acquisition strategy impacts the methodology that it uses to integrate. I will take a little time to look at transition teams and their effectiveness in integration. Then we're going to look at human resource integration planning and goals.

Earlier Linda had asked if any of you have been involved in any mergers and acquisitions. I'd like to take a poll to see how many were employed by a company when it announced that it was going to be acquired or merged?

After hearing the announcement, after hearing which company was acquiring you, or finding out who your merger partner would be, what were the first questions that came to your mind? What's going to happen to me? Do I have a job? Am I going to have to relocate?" Addressing the human resource issues is very, very

critical. I'm glad to hear that Pennell and Linda, as actuaries, have recognized this, as has the human resources profession. Finally, I will cover some lessons we learned at WellPoint.

I'd like to provide an overview on WellPoint. We have 54 locations, about 11,500 associates, 7.3 million medical members, and 32 million specialty members. We have multiple brands. We sell by the name of Blue Cross in California, and we use the name UNICARE outside of California. The stock market knows us as WellPoint.

Our mission states we will meet the changing needs and expectations of our members by offering them a choice of quality branded products. Our goals for 2000 include growing in strategic geographies and increasing the quality and value of our operations, which will result in 15% earnings per share growth. We have focused expansion based on the strengths we've developed in the California marketplace. When we look at possible acquisitions or mergers, we look at the value that WellPoint can bring to that acquisition, not just what we're acquiring or just the assets that we're acquiring. Of course, expected return should exceed the cost of capital.

We have four primary considerations in achieving our M&A strategy. One is looking at the business environment or regulatory environment and ensuring that it's favorable for our business. Again is there an opportunity to add value for members and shareholders? Is there an integration fit? Are we familiar with the products? Is it structured similarly to how we're structured? How well does it fit within WellPoint's portfolio? Will expected returns exceed WellPoint's cost of capital?

Every time WellPoint has done an acquisition it has been our plan to integrate rapidly. We have not done any acquisitions where we've left it as a stand-alone division, although that might be a strategy that a company could use. Our strategy is always to integrate the acquired organization into WellPoint to leverage some of the value that WellPoint brings to the acquisition.

We use the transaction as a lever to accelerate change. When you announce a possible acquisition, or at the time you close an acquisition, people expect change. The members, providers, and your associate population all expect change. We use that expectation to accelerate change and to integrate rapidly. We focus on building on the combined strengths, we quickly try to solidify a vision for the future of the combined organizations. We rationalize the organization and operations and position for top results. Hopefully, the end result will enhance our reputation as a strong national player and a market leader.

Having done several mergers and acquisitions, we've done a lot of research on how to do them better. We've poured over the consultant studies to find out what makes mergers and acquisitions successful and why they fail. I'm going to highlight a few areas that are very critical for us, and we find it to be true in every acquisition we do.

Cultural compatibility is an issue that needs to be addressed early on. It needs to be recognized. Communication programs are critical. You can't communicate often enough with the acquired company, associates, members, and other stakeholders who are going to be impacted by the acquisition.

Consulting studies report that the rapid pace of integration is a primary reason for determining the success of a merger. I'll focus on poor post-merger integration.

I will highlight additional keys to a successful integration. One would be recognizing personnel retention issues early on. Sometimes people look at an acquisition as maybe acquiring members or acquiring assets. But you're also acquiring intellectual capital. You need to identify this intellectual capital and make sure you're retaining the key individuals who can make the acquisition work, help in the integration, and have everything to do with the success of the organization that you're acquiring.

Again, open and continuous communication comes up. I would also highlight making decisions promptly and acting decisively. This plays off of Pennell's presentation. You can get in a mode of analysis paralysis. There are a lot of data to evaluate. But, at some point, you have to make a decision and move forward. Share the decision with the rest of the organization so that they can move forward.

WellPoint has used what we call transition teams to accelerate and integrate the acquisition. The way we structure our team is modeled after the structure of our company. We are organized into several divisions who are focused on a particular market segment. We have an integration coordinator from each of those divisions join the integration team. We have a representative from the company that's being acquired to join the team as well. For example, we have a senior and specialty division that focuses on the senior marketplace and specialty products. A coordinator representing that division joins the merger and acquisition integration team to represent that business during coordinating and integrating activities.

We have each of the corporate areas on the team as well, including finance, branding, legal, human resources, and systems. This team has the big picture of the project at hand. It has an idea of the synergies you want to obtain. It understands the legal aspects of the deal. It is also responsible for coordinating multiple small teams beneath it in order to work out the details of the plan. This is a high-level team that is linked to several sub-teams who are working at the detailed level plans within the business units.

We've found that it is critical to correctly pick team members. They need to have enough authority to make decisions. They need to understand the big picture in order to recognize cross-functions. They must recognize where their organization might bump up against something that's happening in another part of the organization. They must have the authority to make decisions and enough knowledge to know when that decision needs to be escalated to senior management.

We've found you should use this team to communicate back to your organizations. In order to make sure that they're doing the proper communication, it is exclusively their responsibility to go back to their organization and communicate through informal channels the status and details of the integration.

Earlier I mentioned communicating often and frequently. You can use formal communication channels such as newsletters, minutes, notes, and that kind of thing throughout the organization. Informal communication is critical, and we have made that part of the coordinator's responsibilities.

We've also found if you're going to move rapidly and integrate quickly, there is a need for two other teams. These teams can be made up of some of the same members as your coordination team, and/or representatives from other parts of the company. We create a communications group. The communications group meets frequently, usually weekly or more often, as we come closer to the close of the acquisition. This team is responsible for defining all the communication channels and the communication constituencies that needed to be addressed, such as providers, members, a legislator, regulators, and of course, the associates.
We call the day the acquisition closes day one. We have found there are so many activities we have projected for day one that we need a day one corporate group. This group focuses on our goals for day one, and what will be in place for day one.

It is really important to have each team coordinator's roles and responsibilities well defined and clearly stated. They're responsible for developing a full work plan for the integration. It is their job to review the scope of the team's responsibilities and strategic objectives as it relates to that team. They must be aware of the synergies that they're expected to obtain through the deal, the objective of the particular acquisition, and any legal intricacies to the agreement. They should apply all these factors to developing their work plans. They define tasks and deliverables necessary to integrate, and they establish the responsibilities for each task. When they develop a work plan, each task has an individual held accountable for getting it done.

Another key responsibility of the team coordinator is to define information requirements from other processes and cross-functional teams. Again, they have to understand the big picture so they can understand how the timing of one team's integration plan is going to impact the timing of other teams' plans. This is critical to allow things to be staged and to ensure they happen in the right order. Finally, they prepare a detailed work plan.

Just on the human resource integration planning side, we look at communications programs, organizational design, and change management plans. How are you going to work people through the change? How are you going to stage change so it makes sense to the individuals? If there is going to be restructuring, how are you going to do it? What kind of process are you going to use to restructure? And then, of course, address "the me" issues for everybody: policies, benefits, compensation, value, the total value package that the individual will receive if they remain employed with WellPoint.

Again, when I say day one, I mean the day the transaction closes legally. Our goals have been, by the time the transaction closes, to have all employee communications distributed about benefits, titles, grades and salary levels, so that people understand what it means for them if they're going to remain employed with the combined company or with WellPoint.

All associates are put on a common communication platform. Again, this speaks to the culture in the way in which an organization communicates. Voice mail, e-mail, and other communication vehicles need to be in place on day one if you're going to begin to integrate the organization and combine the strengths of the two organizations.

Ongoing communications need to be put in place and continue for all constituencies. All associates are on the WellPoint payroll system. It has been our goal to always convert on day one to our payroll system. This ensures employees are on a common benefit platform and a common compensation platform. Headcount, salaries, and administrative costs feed our other systems so management can begin looking at those numbers and managing them. All hired managers have been trained in policies and procedures, so that they can start operating in the new environment.

We've found that when you look at cultural change and the impact on a new acquisition in terms of culture, most of the work is done through the finance systems and human resource integration activities. Those are the informal definitions of how your culture operates. Items such as your policies, how your systems work, how you keep your books, how you do your budgeting and planning are all reflected in the company's culture. The finance, human resource, and systems teams tend to really clash and have a big impact on cultural change over time.

Some additional HR integration concerns include compensation; a concern people want addressed immediately up front. How are you going to treat my base pay? Are there incentive plans? How do you manage performance at your organization? Do we try to address that before the close or immediately after close?
Benefits are very important. Everyone wants to know what their health, welfare, and retirement programs will look like. Payroll conversion can either be very simple or very complicated. If you're lucky enough to be on very similar policies and programs, payroll isn't an issue. But if you have varying work hours, different pay schedules, one week in arrears versus two weeks in advance kind of pay schedules, payroll conversion can be very tricky and needs to be addressed because it affects people's cash flow.

Policies are critical to address. We've found that the most emotional policy for people is PTO, or paid-time-off programs. Immediately people look to see if there's a balance between what they had and what they're going to have in the future, and it becomes a very personal issue for people when they look at paid time-off programs.

If there is going to be restructuring, how are you going to do it? How are you going to do the staffing and the recruiting, the assessment and selection? Will you work to re-deploy people? Will you try to place them in other locations or at other places in your organization? And if you can't re-deploy people, are you willing to relocate them or provide them transition benefits, such as severance and out-placement? It's not the prettiest thing to talk about when you first meet with an acquired company, but it's the top question on people's minds. If I get laid off, how are you going to support me in transition?

Finally, some lessons learned. Don't underestimate the cultural differences that can create barriers to integration. Leverage off the expertise of the acquired associates. If you're leveraging off their ability and skills, you're beginning to blend culture immediately. Address integration issues honestly and quickly to avoid feelings of mistrust and suspicion. As Linda had mentioned earlier, if you don't have an answer, address that. We haven't finished our analysis on that, or we don't have an answer to that question, but here's our timeline to get you an answer. A lack of information creates wrong answers as people fill in the void for themselves.

Communicate the vision, strategy, and policy changes clearly. You might think it's a little weird for me to have policy changes in the same line as vision and strategy. I believe that until you tell people the policy changes and how it's going to impact them, they won't care about vision and strategy. They want to know how the merger is going to impact them as individuals.

There's no such thing as overcommunication. Identify key personnel early on. Develop detailed plans, linked to the business goals and link these plans to individual performance expectations to get results. Consider both long-term and short-term impact and the importance of planning and executing. Establish a well-defined structure for the integration process. From our experience, we've realized you really can't put enough structure on the process of integration. That's why we began to form teams that are defined in very distinct and very clear ways.

Designate a core group of acquisition experts. Some people in our company have been involved in a number of acquisitions. You really do learn from practice. You get a little bit better at it each time. There are always problems and issues. Every acquisition is a little bit different, but it gets easier if you've done it a couple of times.

Set performance expectations and established reporting relationships at the close of the transaction. This was a big lesson for us. When the transaction closes, who reports to whom? Who is in control? Who is managing this thing? It is very critical that reporting relationships are identified immediately. As quickly as possible, set performance expectations, especially for the acquired management team members, so they stay focused on the activities they need to be focused on, and are familiar with what expectations the company has of them.

In summary you can't overcommunicate. Each of us has said that. In WellPoint's experience, you can't integrate rapidly enough. You can never do it fast enough to

satisfy your associates, your members, your providers, and so on. So the goal is to do it as rapidly as possible. Don't underestimate the need to address "the me" issues. Address the "me issues" first, before you move on to other integration activities.

Ms. Rosenblatt: I hope everyone benefited from a lot of the similarities. I've been to a couple of M&A integration seminars dealing with various industries and it's just amazing how much similarity there is in what you've heard here and what I've heard discussed at these seminars.

Mr. Timothy I. Martin: This question concerns Pennell's merger. You discussed the plan for 1998 and then also how your 1999 actual results turned out. In those same categories that you were talking about, as far as run rate overhead, can you give some kind of explanation about where the big profit came from? Could you also define the run rate? I was wondering what kind of product profit is in terms of a percentage of revenue?

Mr. Hamilton: When you said the big profit, do you mean the 1999 profit?

Mr. Martin: Correct.

Mr. Hamilton: The 1999 profit was nowhere near the $113 million, but it still seems like a big profit. As for percentage of revenue, we're running just a little under 3%, which isn't quite what I wanted. We wanted to be around 4%, but given the turnaround, this result was pretty good. The way we define run rate is basically based on restated financials, so we go back and restate for reserve changes and then restate for any one-time events. And I know this is the financial side, so we have things like retroactive premium recoveries on Medicare, for example. So we take all that out, and that's how we define run rate. That's what I always use as a base. I generally try to be pretty brutal, because I've always felt that being conservative on that and having a lot of plans and a lot going on, is not a bad way to be.

I think you're asking what accounted for the profit. The reality is that none of the expected synergies were unreal. What was unreal was the expectation of the timeframes it would take to actually get there. When you're going through a merger, you have all sorts of competing stuff going on, on the culture side. To try to be able to achieve all those plans immediately was a little unrealistic. In reality we achieved a lot of the medical management savings, basically through some of the basic blocking and tackling of better claim payment through things like code review. We achieved almost all the expense savings. We actually achieved most of the synergies in that list. It's just that the base rate wasn't where we thought it was, and the expectations of timeframe were unrealistic.

From the Floor: I have a question in regards to your information reporting consolidation. Can you talk a little bit about the personnel management structure and changes that you went through in getting there, and where the division sits in the organization? The second issue is, as you've consolidated, do you have trouble

allocating resources for reporting across different functions? It seems like our company's demand for reports always exceeds the ability to deliver reports by a pretty large margin. How do you cope with that issue when you have to compete with different functions in the organization?

Ms. Bronstein: Yes, we deal with all of those things. From a personnel management standpoint, prior to functions merging, the various units reported out to the legal entities and business unit structures. We brought them into one division. They report to the Midwest chief actuary, which is my title. These units now do account reporting, clinical analysis, provider profiling, cost of care reporting, experience analysis rate filing, data gathering, and analysis, and so on. One of the reasons for putting all of the reporting together was to get to a one-company approach and definition. We found when we merged that it was like the Tower of Babel. People had different definitions and understandings of what data meant. Paid date had a different definition based on operations systems. Sometimes it meant the date of adjudication of a claim. Other times it meant the date that the actual check was cut. People were using information across the organization differently, based on their understanding of the data. Those were some of the reasons and the struggles behind putting the reporting all within one unit to give us one mechanism and one way of working.

Regarding allocation and prioritization of resources, I think all companies deal with that issue. There is never enough information to meet everyone's needs. We work it from the perspective of client focus. We are functionally organized into a shared actuarial and reporting analysis department that supports various business units such as individual, the local group business, and so on. I sit on the senior team. Based on the priorities of various business units' general managers, I give direction to the actuarial and reporting analysis units. I escalate conflict about priorities when there just aren't enough resources to go around. I ask if general managers want to pay for more resources to meet the particular information needs that they are now requesting. Many times the general managers find that they have similar analysis reporting needs, and we find it more effective to add the resources or to redeploy resources because they also recognize that some reporting isn't quite as useful as it once was.

Some of the recent breakthroughs were getting our entire health care management area more unified in the Midwest and getting them to agree to use information from the same types of reporting structures. Agreements on those issues made the delivery and the effectiveness of setting priorities much easier. The key to it is participation and recognition by management of the various business units and the information technology areas involved in a project. We have what we call the horrendous project definition document (PDD). It is basically a request for resources and going through an ROI of what those resources and information delivery will provide the business unit and the company. The value return is identified and then tracked to see if it actually delivered. It took the company a while to implement. I would say in the latter part of 1999 and in 2000, we've really made that process work. The first PPD Projects in 1997–98 were struggles to get everybody to the table, to define what their needs were and to identify a value

return to the company. We needed to determine where we wanted to spend the dollars. Now there is a whole process in place from a corporate standpoint.

Mr. Dean E. Fiscus: My question is, as you were going through the mergers, was there a significant loss of membership on the block of business that you had purchased? I'm asking about the medical membership. As you started doing integration, were customers uncomfortable with integration, and did they go to other health plans?

Ms. Rosenblatt: Let me address that from my experience and knowledge of the industry, rather than deal with it for any particular company. I think the loss of membership is obviously very dependent on what your strategies are. WellPoint has had this experience. We purchased plans that were under-performing: John Hancock and Mass Mutual. We knew going in that we were going to have to take severe rate actions. We built into our valuation model an estimate of the impact of the planned rate actions, and an assumption that those rate actions were going to lead to loss of membership. So we went in knowing that was going to happen. You can also have an unfortunate thing where you lose more members than you anticipate in your model, or you lose members through the actions that you didn't anticipate. Pennell was talking about the situation of the low paid claims and the buildup of inventory. If you trace that through and think about the service implications of that, and I don't know if that was true for him, but many companies have experienced bad service as a result of system conversion or other issues that will lead to loss of members. Anybody else want to comment on that?

Mr. Hamilton: I'll make one comment on it. We had a slowly declining membership, but it was not related to the integration. It is the implementation and service problems that cause you to lose your customers. The trick to that is to get on top of it and get it fixed. I think that some of that is going to happen anyway when you change systems and people are used to something familiar.

Ms. Bronstein: My experience has been very similar. The service issues were by far the most important, from a member standpoint, in retaining or not retaining business as we went through the integration. Some of our operations areas that were integrated were more effective. Other areas might not have had adequate assistance, where the planning wasn't as good, or it had operational issues, large backlogs, and customer service issues that led to loss of membership.

Mr. Fiscus: I have a follow-up question. We're talking about the membership loss in the block of business that was purchased. Did you see any impact on the existing block of business that you had; for example, if you're dealing with service issues, did that have any impact on your existing block of business so you lost membership on your existing block as well?

Ms. Bronstein: My answer is yes, depending upon where you were integrating in the acquired block. Alice also mentioned, in some instances the strategies for turnaround are going to play into whether you expect to retain or not retain the membership.

Mr. Harry L. Sutton, Jr.: I have a hypothetical question. At least one of our big clients has decided to outsource all their basic claim functions and data collection functions and to transfer a large number of people to a long-term contract with a computer system manager. That problem seems somewhat similar to that of merger and integration, where you're going to have to change somebody's system or synthesize them into one system. How do you compare those problems to trying to outsource a major information systems function to an outside company? A lot of insurance companies, such as my old company, Prudential, outsourced everything to IBM. Do you have any comments on this outsourcing? It's not exactly a merger and acquisition; it's almost a matter of separating out a segment.

Ms. McNamara: There are a lot of similarities. Addressing "the me" issues becomes number one priority for the outsourced individuals. When WellPoint outsourced parts of its information technology (IT) functions to GTE, the early issues were similar. What's the timing for the outsourcing? How's it going to impact my job? If I don't have a job in the end, will I get severance? What kinds of benefits will GTE give me? What happens to my service with the company? There are a lot of similarities when you go into an outsourcing situation, at least for the human resource aspects of the activity.

Ms. Rosenblatt: I think the change management aspect really comes into play there. I find there are a lot of similarities between turnaround and merger integration, and I think outsourcing would be the same thing. In all of those things change management comes into play. The "devil is in the details," and you have to make sure that all those details are taken care of, and that all the dots that need to connect are connected, or you could end up with some pretty bad problems.

Ms. Bronstein: One of the key things that we've found on outsourcing is you must think through the alignment of incentives and service level agreements. Consider the vendor or the outsourcer very much as another unit of the company that has to deliver for success. You have to be able to make sure in the contract that the expectations are clearly defined, measurable, monitored, and leave nothing out. We ran into some issues in some of the outsourced items as service levels were not appropriately defined for monitoring, and some areas of the company suffered. So be quick to monitor and check through the organization as the actual outsourcing occurs. Where you have service level issues, quickly jump on them and identify whether there are misaligned incentives, goals, or undefined service level monitoring and get on it quickly. Outsourcing is just like setting up a merger or trying to make a cohesive restructuring of a company.

From the Floor: I have questions for Barbara related to the management process for forming the transition teams, which you indicated would be made up of representatives from both companies. What in your experience has been the process by which those teams are chosen, and more specifically, how is the leadership of those teams chosen? Are they chosen based on relative rank within the merging or the acquiring companies? Are they chosen based on individual leadership skills? What's the accountability of that person, and is there an executive sponsor that is active in each of the large number of committees that get formed?

Ms. McNamara: Alice can probably help me with it as well. Alice was the leader for the merger and integration team. She was identified by senior management as the lead individual. She solicited coordinators from the various businesses to sit on her team and she clarified what their role would be. She asked for people with the appropriate level of authority and for people who could speak to the big picture and work out project plans. She also asked for people who would have enough authority to pull together other subteams and to have enough authority to get subteams working on subtasks. That was on the WellPoint side of the house. On the acquisition side of the house, our experience has been that their management team serves on those teams. There are different people from the functional areas. The senior manager from the functional area is on the team.

Ms. Rosenblatt: I think either Pennell or Barbara said it clearly; there have been instances where the person who was selected to head up a team was not the right person and, because speed is so important, you have to react quickly to that. In the structure we set up, there's a dotted line reporting to me by the leader from each team, and it's given corporate importance. In my two roles, I report to two different people. I report to the Chairman in my M&A integration role, and I report to the CFO in my chief actuary role. So M&A integration is given a very high level of importance in the company. Associates' individual performance plans are connected to the integration process with goals, and we try to quantify as much as we possibly can. We're a very analytic company and most of the stuff we try to deliver on Day One concerns getting as much information into our management information systems as possible so that we can track progress.

Ms. McNamara: I think that has evolved over time. Initially, our team coordinators didn't have, as part of their performance plan, the M&A activity. Later we realized we needed to build that into their performance plans and make it a critical, if not the number one item that they were expected to focus on. We've also run into problems with individuals who haven't had enough authority to act on the requirements of planning or act on a particular decision. Alice has worked quickly to make sure that was taken care of.

Ms. Rosenblatt: We also take the approach Pennell was talking about; make a decision, any decision, but just get it done. I think that's real important, and one of the ways we deal with that issue is by having very clear goals for each team. Our finance team, for example, knows they have to get everything into the WellPoint general ledger. There is no discussion with the acquired company about having the best general ledger in the world, which would give us all the stuff that our system can't. We must have all of the financial information on WellPoint's general ledger. End of story. To the extent that we need to have different reporting, we will figure out ways to do it. Many of those decisions are made prior to the announcement of the deal. It takes a lot of the things Pennell was talking about out of the picture. Do you want to add anything Pennell or Linda?

Mr. Hamilton: I'd like to make a quick point of clarification, if I could, Alice. You're talking about those kinds of decisions where you had the authority to both make and communicate to the leadership of each of the teams?

Ms. Rosenblatt: Yes. We normally have a set of deliverables that we expect on day one. They have developed over time and are now very, very clear. To give you an example, we signed a definitive agreement with Rush Prudential in Chicago on December 9th. On December 15th, we flew in about 25 people from California and elsewhere to meet with about 25 of their top people to start the integration process going. Part of the kick-off meeting included a list of things we needed to do prior to close.

Mr. Hamilton: Just a quick comment. I commend you on that process. I've seen it attempted otherwise, with the decision-making process more disbursed, and it has been difficult to work with.

Mr. Rowen B. Bell: This question is for Barbara and Alice. Your company has been linked with acquisition targets that are substantially smaller than and substantially larger than your own company. I wondered if you could address how some of the integration challenges that you talked about in your presentation would differ when trying to absorb an organization that's significantly larger than your own?

Ms. Rosenblatt: I'm not going to dwell too much on it, but I think that a lot of what we talked about would need to be fine-tuned and worked out differently with a very large acquisition. Barbara?

Ms. McNamara: Yes, but I'd like to add to Alice's comments. The acquisitions we've done so far have always been small enough to integrate or absorb into part of WellPoint. If it were a very large organization, we might have to look at our processes a little bit differently if we're going to take on an elephant.

Ms. Rosenblatt: Yes, and some of the things I spoke about such as going to WellPoint's general ledger system or WellPoint's payroll system would be looked at differently if it was an extremely large organization. One had more membership than we did. In general, our seven million members drive these decisions. We're not going to convert our seven million members or our 11,000 associates to some other system, no matter how good it is. But if our seven million members, for example, are smaller than the company that we'd be acquiring or merging with, then some of that would need to go through an analysis phase. We would hope a lot of that would be done as part of us building our valuation model and working through the terms of the agreements. Pennell, I think you want to add something?

Mr. Hamilton: Yes, I think it is different when you acquire someone roughly your size or bigger. The example I was giving was more a merger of equals. When I was listening to Barbara's presentation, I was thinking that sounds like a great process. But then I realize it's a little easier when you know who's winning and who's losing because the power is clear. When you're talking about a bigger

merger, I think the lines are not as clear, so you need to think through things a little differently.

Mr. Garry M. Eckard: In general, what have you observed in practice with regard to the top management of the companies that are, in effect, being sold? In reality, are they typically replaced, and how is that handled with regard to the top four or five people in the selling company, or the company that's, in reality, losing power in a merger?

Ms. Rosenblatt: Each one of us has a different answer. My answer is I've seen everything. I've not only seen what WellPoint has done, but I've observed other companies with whom we have not done a transaction. You might run into a situation where management has change of control provisions. The management might be pretty well protected, and in some instances, they may actually hope that you do terminate them or put them in a lesser job because it will trigger the change of control and give them the opportunity to move on to different things. In some instances, when you value the deal, part of the value might be that there's a terrific management team, and you want to do everything possible to retain them, so you want to look at your retention program. In other instances, you might walk into a situation where you look at the management team and the performance and say the first thing we have to do is change the management team if we want to improve performance. So I think all of that can happen.

Ms. Bronstein: Just a comment to add. In today's tight labor market, we do like to retain as much of the talent we acquire as possible. Of course, at the top management levels, that can create duplicated positions. We try to assess the talent and skills of that organization and try to retain as much as possible. We're eventually up against the wall trying to fill those jobs if we don't retain the people that we acquire.

Mr. Hamilton: I agree with Alice. I've seen everything. When the smart companies pick a management, they either pick one or the other management or install a new management until they decide what they're going to do. Sometimes a situation happens where there is a sort of lingering. In the situation I was in, it was fairly clear. People knew the management of the prior company was eventually going to be out. As part of the deal, they were in for a while, which created a lot of the issues that we saw here. In the end, I think the smart companies put their bets on one management or you bring in a new management, but you've got to do one or the other.

Ms. Bronstein: Some of the aspects were due to changes that Alice talked about, such as size of the merger/acquisition, reasons for the merger, some of the desires of the management and staff can apply. The experience I went through in the Midwest, when the Kentucky, Ohio and Indiana plans merged, was one in which the management team interviewed for positions on the senior team in the merged Midwest organization.

The company's goal was to retain management with the best practices and talents. There were not enough senior team management positions for all that interviewed. However, there were key positions for others that would leverage their skills and experiences. So it might not just be the top management level positions that people get. There are always things going on with mergers and acquisitions where positions have been found.

CHART 1
THE "SYNERGY" PROBLEM