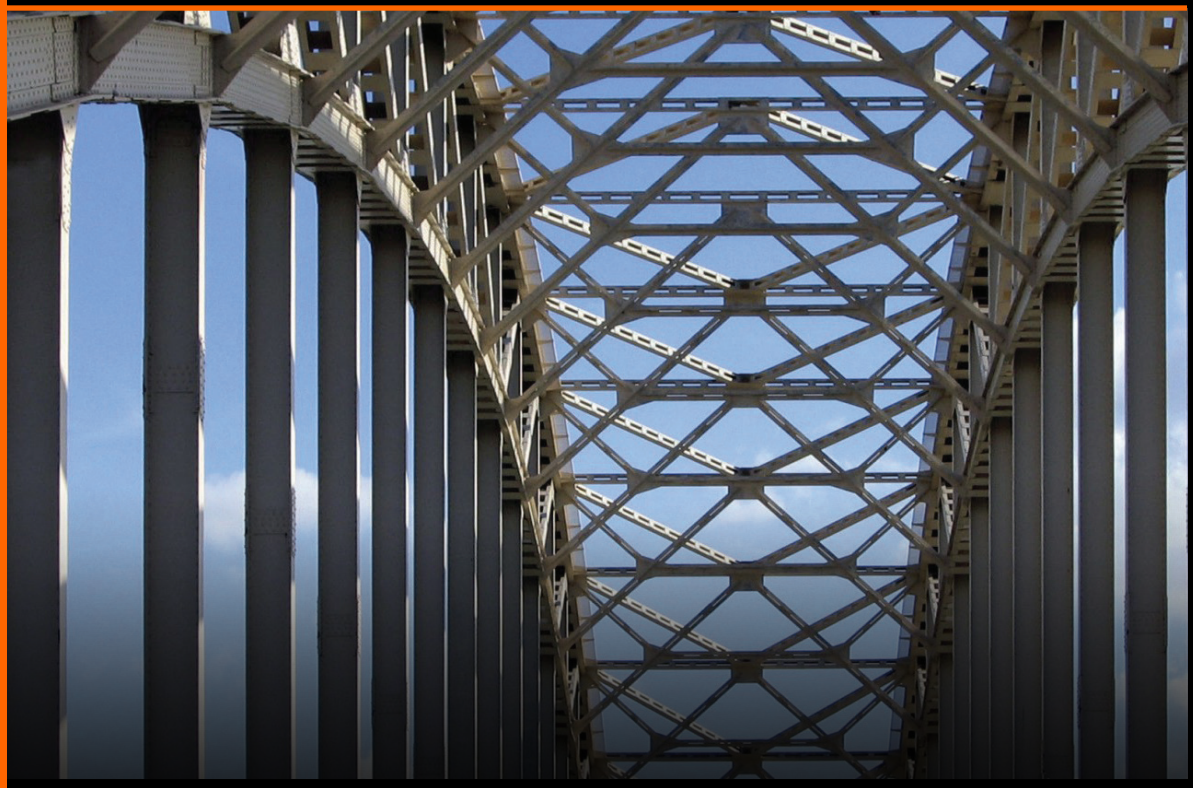
WHITE PAPER

CEO AdvisoryGroup

Growth Planning | Mergers | Integration



Growth by Merger:

Mergers Offer Credit Unions a Strategic Growth Opportunity



Traditionally, credit unions have measured growth through one of three lenses: asset size, percentage of loans to deposits, or membership numbers. However, credit unions are increasingly viewing growth opportunities through a fourth lens—strategic mergers and acquisitions.

A merger of credit unions affords an opportunity to accelerate growth by increasing market share in existing markets or expanding into new ones. It also provides an opportunity to gain economies of scale.

This white paper provides an overview of the many advantages credit unions gain from strategic mergers and introduces critical considerations for a successful merger that makes two credit unions stronger together than they were alone.

Credit Union Mergers on the Rise

Credit union mergers and acquisitions have been on the rise for several years. In fact, credit unions have been merging at the rate of 2.9 percent per year since the industry reached its peak in 1969 with 23,766 credit unions.[1,2] As of June 2015, there were 6,281 credit unions.[3] According to the National Credit Union Administration:

> Between 2003 and 2012, there were 2,462 credit union mergers. During this period, the total number of credit unions declined from 9,369 to 6,812, or 27 percent. In other words, over a nine-year period, a credit union merger occurred approximately every 1.5 days, which underscores how commonplace these transactions are.[4]

While mergers are not new, what *is* new is an increase in *strategic* mergers—those driven by the need or desire for economies of scale, regulatory pressures, and consumer demand for more leading-edge services and banking products. A growing number of credit unions are considering mergers as a smart way to streamline operations, build membership, expand fields of membership, and leverage economies of scale.

Whereas in the past mergers were typically driven out of necessity when a credit union was floundering, today large entities are combining forces strategically—driven to boost their combined assets into one even-stronger entity.

In a study on credit unions, the Filene Research Institute found the seeds of a trend—large credit union mergers, or what Filene termed “mergers of equals.” This is when two healthy credit unions of similar size combine assets and capabilities in order to improve their competitive position in the marketplace.[5]



It's no longer unusual to find two credit unions worth over $500 million become a single billion-dollar entity—something *Credit Union Times* calls "the billion dollar club." The publication pointed out that acquisitions and mergers are a leading factor in credit union growth strategies today.[6]

CreditUnion.com stated: "If history is any indicator, mergers in the credit union industry...might become more prevalent as innovation and change favor size and scale."[7]

Indeed, the average asset size of all mergers is on the rise, according to the Credit Union National Association. At the end of 2013, the average credit union had grown to nearly $160 million in assets. Just 13 years earlier the average asset size was $42 million, a quarter of the size of today's credit unions. Extrapolating this growth and consolidation 10 years into the future, the average credit union size will be nearly $600 million by 2023. In 20 years the average credit union will be nearly $2 billion.[8]

Growth Resistance in Credit Unions

Today's growth trend puts even more pressure on credit unions to take proactive strategic action to remain viable—because credit unions with small asset sizes will face a daunting struggle for survival among the increasingly larger credit unions.

In a study, CEO Advisory Group found a 150-basis point difference in operating expenses as a percent of assets between credit unions with $100 to $500 million in assets and organizations with $5 billion in assets. This is a huge difference with significant ramifications. It impacts factors such as how much a credit union can pay out in deposits, what loan rates it can offer, and what membership population it can offer loans to.

Despite these market pressures, not all credit unions are facing the issue of growth head on. Many report being comfortable with their current size—including membership numbers and assets. But this view typically fails to account for changes in the organization, economy, and marketplace five, 10, or 15 years down the road.

Nonetheless, as more large credit unions enter the market, size will become an increasingly significant issue for everyone. At the same time, traditional ways of growth will become increasingly challenging. For example, adding a new branch will become cost- and time- prohibitive. Today it costs one to three million to open a new branch and can take from five to seven years to reach profitability.





Planning for Growth: The Strategic Growth Plan

In today's increasingly competitive financial marketplace, every credit union should contemplate the option of growing through mergers. Time is of the essence, both because the process can take a few years and the best candidates may have already merged with other entities.

The first step is to develop a strategic growth plan. This plan identifies the various options a credit union has to grow—for instance, by expanding within an existing geographic market, or into one or more new ones. In preparing this plan a credit union would evaluate such factors as:

- Market characteristics
- Competition
- Product purchase characteristics and product demand
- Demographics and psychographics
- Cultural fit
- Population density
- Market growth rates
- And more

The goal is to identify the most effective means of growing membership size, number of branches, and deposits. This includes growing faster and more profitably without diluting the capital ratio.

Identifying Candidates: The Strategic Merger Plan

Once the criteria of the ideal acquisition target to support the credit union's growth plan are identified, the next step is to develop a strategic merger plan. This evaluates the credit unions in the target markets that meet some, if not all, of those criteria. Some of the quantitative and qualitative factors to be evaluated include:

- Field of membership (FOM)
- Federal or state charter
- Profitability
- Branch network
- Net worth ratio
- Management team





- Distribution and quality of membership
- Culture
- Potential synergies

It's also important to consider what makes an acquirer attractive to the acquiree (or "target"). The target needs to see value for their credit union and buy into a common vision shared with the acquirer. This requires carefully-orchestrated dialogue between the leadership of the two credit unions, and is best facilitated by a third party.

Throughout this analysis and discussions, the goal should remain clear: identify acquisition targets that enable the two credit unions to be stronger together than separately—to the benefit of members, employees, board members, and the community.

The Role of Trusted Advisors

Merging with another entity opens the door to opportunities for credit unions—allowing them to grow in a more cost-efficient manner. By working with an experienced third-party consultant, the otherwise complicated and time-consuming merger process can be greatly streamlined.

Along with providing expert guidance, third parties can also provide anonymity for the credit unions seeking merger partners—which helps protect the CEO's confidentiality so they avoid negative feedback, such as being viewed as an industry "piranha."

While a CEO will typically only have one opportunity to make a merger inquiry with a potential merger partner, consultants can keep the conversation going with viable candidates. They not only make the initial contact with potential merger partners, but also handle the research and discovery process, build the relationships with viable candidates, and execute the merger process for credit union CEOs.

What's more, third-party partners with merger experience can help two merging credit unions find common ground, overcome common challenges, and find innovative solutions.

The Value of a Structured Merger Process

Because most credit unions leaders will only go through one to two mergers in their careers, not only do they not have the experience, but they also don't have a structured process in place for this business initiative. An experienced merger advisor will have a clear step-by-step process in place to structure the entire process. In particular, an





experienced consultant will understand the politics of combining two boards and two groups of employees—and how to create balance so the two credit unions are better together than they were alone.

CEO Advisory Group has managed dozens of credit union mergers, and has the experience to offer a unique blend of merger experience, cultural sensitivity, and financial industry operations involvement to every advisory assignment. Vast experience with boards and CEOs has provided us the insight and compassion to understand the many factors that drive issues around credit union mergers, as well as the obstacles that may hinder the process.

Having a trusted advisor with industry experience to guide each step of the way makes the challenge vastly less complex. CEO Advisory Group's proven process first identifies the right candidates for cultural fit, shared values, membership advantages, and vision. Then the advisors successfully and seamlessly market and negotiate credit union mergers.

Today, more than ever before, it's crucial that credit unions rise above the status quo and look for new ways to grow—including strategic mergers. Partnering with CEO Advisory Group provides an opportunity for credit unions to take advantage of today's leading credit union growth path.

For a confidential discussion about your credit union's situation, contact CEO Advisory Group.

www.ceoadvisory.com | 206.219.5395

1. http://ceoadvisory.com/average-cu-2-billion-in-assets/
2. http://www.cuna.org/WorkArea/DownloadAsset.aspx?id=57716
3. http://www.cuna.org/Research-And-Strategy/DownLoads/mcue/
4. http://www.ncua.gov/services/Pages/small-credit-union-learning-center/Documents/Truth-In-Mergers.pdf
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6. http://www.cutimes.com/2015/02/10/15-credit-unions-reveal-merger-plans
7. http://www.creditunions.com/blogs/graphic-of-the-week/4-charts-about-credit-union-mergers/
8. http://ceoadvisory.com/average-cu-2-billion-in-assets/

CEO Advisory Group serves as a trust-based advisor to credit unions providing mergers and acquisitions and growth planning. CEO Advisory was the first M&A consultancy with an exclusive focus on the credit union industry. Our goal is to successfully ensure members, communities, board and staff all win in mutually beneficial mergers.