WHITE PAPER

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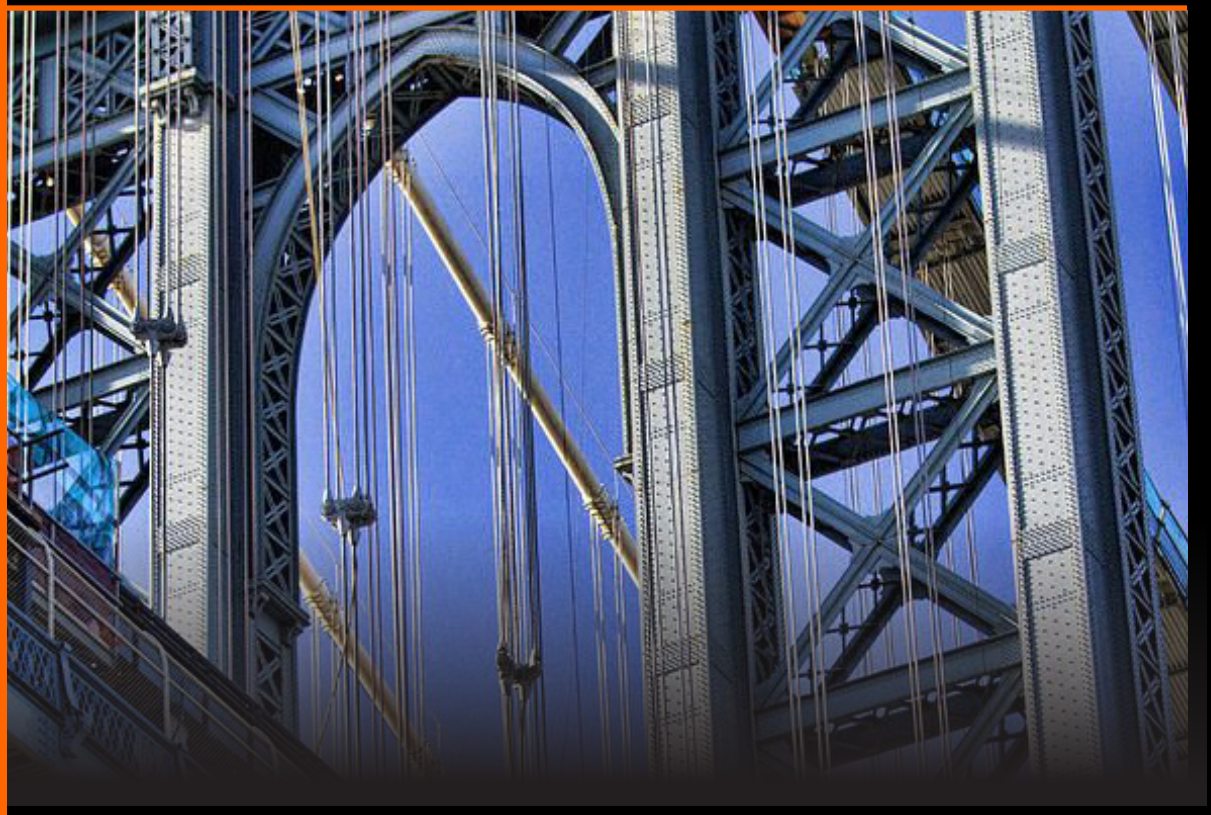
Growth Planning | Mergers | Integration



The Strategic Growth Solution:

How Mergers Help Small Credit Unions Stay Viable



At a time when small credit unions need to grow to stay viable, several market pressures are bearing down on them and making growth more challenging. Pressures range from declining or stagnating membership, demographically changing locations, and a lack of services and products to meet modern members' demands. Compounding the problems is a lack of resources to invest in growth initiatives. As a result, month after month since 2010, nearly half of small credit unions have had no or negative growth in members.[1]

This white paper provides an overview of the many challenges facing today's small credit unions—many of which are finding the marketplace increasingly dominated by ever-larger credit unions that have the financial strength to attract larger numbers of members with more services, branches, and loans.

This paper also shares insight into the many advantages that small credit unions can gain by growing through mergers with other healthy credit unions—thereby expanding membership, locations, services, and deposits all in one strategic move.

The Rapidly Shifting Credit Union Landscape

The definition of what constitutes a small credit union has increased steadily over the years—from $1 million in assets to $100 million, according to the National Credit Union Agency's (NCUA) Office of Small Credit Initiatives. Even so, the number of small credit unions today is slightly higher than it was in 1990.

According to the agency, there were 3,807 credit unions classified as below $1 million in assets in 1990. As of June 2015, 3,910 had fewer than $50 million, which was the small credit union asset ceiling at that time.[2] The ceiling has since been raised to $100 million, and as of September, 2015 there were 4,690 credit unions under that threshold.[3]

Since 1969, the number of credit unions has shrunk from a high of 23,866 to under 7,000 by 2015. The leading factor reducing the number of credit unions is mergers—which until recently have primarily occurred when large credit unions acquired small credit unions. But today there is a growing trend of mergers by equals—including large credit unions merging with other large entities, and small credit unions merging with other small entities.

As the credit union merger trend continues to grow, average credit union size is likely to continue to grow, as well. And that means a larger number of benefits for large credit unions, their members, and their employees. The impacts of this shift will worsen opportunities for small credit unions.



When is the Right Time to Consider Growth by Merger?

In this sea of credit union mergers and market pressures, small credit unions may wonder at what point they should consider a merger as a growth strategy. There are many significant indicators that signal that a merger is a viable growth strategy—including declines in membership, compliance challenges, and financial burdens.

One of the key indicators is membership growth. Is the credit union's membership growing, shrinking, or stagnating? If it's not growing, that is often an indicator that the entity is not meeting members' needs or not offering the resources necessary to attract new members. Other factors could be at play such as poor branch locations or a lack of leading-edge banking products (such as home mortgages).

In particular, customers today expect a convenient online banking experience. They want easy access to mobile banking, Apple Pay, remote deposit capture, and more. This issue compounds when the millennial population is part of the target audience, because their expectations for online functionality—digital experiences and social media—are particularly high and, as a result, many smaller credit unions are not attracting this audience. Even if a small credit union has these products and services, they often don't have the marketing budget to promote them.

Regulatory compliance is another major problem for small credit unions. In fact, it's created a significant shift in the burden that credit union CEOs and other executives are facing—a shift that disproportionately hurts small credit unions more, because they have fewer people to deal with it. In the past, CEOs spent about 80% of their time working on member issues, including finding ways to provide more and better services to their membership. Today they are spending 80% of their time meeting the needs of the regulators. A study by the Credit Union National Association (CUNA) quantifies the financial impacts of these regulatory burdens:[4]

- Credit unions spent $6.6 billion on compliance-related costs in 2014
- The median compliance cost was 49 basis points of a credit union's assets
- The median reduction in revenue opportunity was 10 basis points of assets

The total impacts are equivalent to 20% of total credit union operating expenses and 40% of total staff expenses.

Finally, there are the financial burdens that small credit unions must tackle—like rate, cost structures, and economies of scale. For example, many small credit unions are saddled with a higher expense ratio as a percentage of assets or as a percentage of



total income than the larger credit unions. As a result, they are not able to offer rates on their products and services that compete with larger institutions.

What's more, small credit unions struggle with their revenue structures. Because they have a harder time bringing in loans, they have a harder time building the income stream. Meanwhile, larger credit unions on average tend to have much higher loan-to-deposit share ratios, thus generating significantly more income. As a result, they can invest in new product development, offer more technology and expand branches—something their members appreciate.

To deal with these financial issues, small credit unions have been cutting corners wherever they can to remain profitable. It often gets to the point that the credit unions have to start cutting employee expenses, which leads to no or low employee growth, stagnant compensation, and reduced benefits—which puts small credit unions at risk for employee attrition.

Even if a small credit union is overcoming all of these challenges and doing well today, they need to also look five, ten, or 15 years into the future, and ask themselves: will we be able to maintain our financial position in the marketplace, or are we likely to keep losing ground? Even credit unions worth as much as $500 million are not necessarily going to continue to be successful in a world surrounded by multi-billion dollar credit unions. On the other hand, if they merge with another successful credit union, small credit unions can boost their size, financial might, and competitive position.

Big Gains When Small Credit Unions Merge

In fact, small credit unions have a lot to gain from a successful merger with another like-minded entity. Everyone from the CEO, to the board members, to employees, to members stand to gain significant value and benefits, for example:

CEOs. The CEO of an acquired credit union is usually very satisfied at the conclusion of the merger process. They take pride in having helped create a new, stronger credit union. They enjoy the vibrancy of the new entity and the opportunity to do more for their community thanks to access to many more resources. The CEO will often be compensated as a result of the change in control. Some CEOs will continue to serve in an executive or managerial capacity in the newly-combined organization, frequently at equal or higher compensation levels than they had previously, and sometimes with retention bonuses as part of an employment contract. If the merger occurs near the CEO's planned retirement, the acquiring credit union might rectify their inadequately funded retirement package.





Board Members. Board members have many opportunities following a merger, including expanded roles on the new board, serving in an advisory capacity, or taking on different roles within the credit union, such as becoming a Supervisory Committee member. As part of a larger, stronger credit union, board members can better tackle the challenging issues confronting credit unions today, such as tightening regulations, expanded educational requirements, cybersecurity threats, and litigation. Boards can now accomplish more with their greater resources—expand membership into new areas, provide employees with better salaries and benefits packages, offer new technology, and grow the branch network.

Employees. They gain significant advantages from a stronger employer, including higher pay rates, better benefits packages, and new promotional opportunities. Rarely do employees who want to stay in the newly merged entity lose their jobs. On the contrary, they find themselves with more opportunities for advancement—something typically not available in a small credit union.

Members. Most importantly, members will gain many significant benefits, including access to the latest banking services and products, a greater opportunity to receive loans, and the excitement of being a part of a successful expansion of their preferred banking provider. In most cases, members will still have access to their preferred branch (or new ones) and their favorite employees.

Gain Support for the Merger Journey

When a credit union's CEO or board members understand everything they have to gain from a successful strategic merger, and have reached the point of wanting to consider growing through a strategic merger, one of the best first steps they can take is partnering with an experienced merger advisor. A merger expert can help credit unions better understand the process and begin the steps required to launch a successful merger process. Then they can guide and manage the whole process—from the discovery stage through integration of the two credit unions.

Look for an advisor that has successfully managed dozens of credit union mergers. In particular, choose an advisor who knows how to work effectively with CEOs and boards.

In addition, make sure your advisor has the right blend of cultural sensitivity and compassion to navigate personal and political obstacles that may appear in the merger process.

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Today, more than ever before, it's crucial that small credit unions rise above the status quo and look for new ways to grow—including strategic mergers. Having a trusted advisor with industry experience to guide each step of the way makes the challenge vastly less complex.

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

www.ceoadvisory.com | 206.219.5395

1. http://www.ncua.gov/News/Pages/NW20141209StateMaps.aspx
2. http://www.cutimes.com/2015/09/11/small-credit-unions-larger-but-challenges-remain
3. http://www.ncuareport.org/ncuareport/october_2015?pg=1#pg1
4. http://news.cuna.org/articles/108422-cuna-study-reveals-cu-2014-compliance-costs-hit-66b

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.