URGE TO MERGE

BY GLENN CHRISTENSEN, PAUL SEIBERT AND MARK WEBER

Credit union mergers aren't what they used to be. These days, they're much, much more.

Mergers are the force behind seemingly contradictory trends in recent years: Membership continues to climb as the number of credit unions contracts—due largely to smaller credit unions merging into larger, stronger organizations.

A good example of this can be found in the recent merger of $93 million Deere Community Credit Union, Ankeny, Iowa, into $860 million John Deere Community Credit Union, Waterloo, Iowa.

"Deere Community Credit Union is in our field of membership, and they were looking to expand services to their members," says Doug Gilbertson, VP/branches at 105,000-member John Deere Community CU (*www.jdccu.org*). "We looked at this as an opportunity to diversify and expand our field of membership and reduce our risk. We currently have 50 to 60 percent penetration in our market."

Dennis Skelton, president/CEO of the merging credit union under this proposal, says Deere Community CU, which has 15,000 members, has been the sole CU presence in a community saturated with banks. "Because we've reached a plateau in growth, we considered partnering with another credit union to take us to the next level," says Skelton, a CUES member. "Although we are very solid financially, we did not feel we had the resources to provide our members with the services they desired in the near term."

As the field of credit unions considering mergers expands, finding the perfect fit is crucial.

ADDING VALUE

Increasingly, it seems, financially healthy credit unions of all sizes are considering mergers both as an acquirer and as the merged entity. We've heard many executives of credit unions in the $50 million to $200 million asset range say they're not currently exploring a merger, but they add that they anticipate their organization may merge into another credit union within a decade.

Many smaller credit unions consider mergers as a way to add value for their members by providing access to high-cost remote delivery channels and an expanded product line. As the CEOs of smaller credit unions near retirement age, they are turning to mergers as an option not simply to find management replacements, but to leverage their capital and cover their costs of technology investment, marketing expenses and member losses.

Meanwhile, medium and large CUs seek to increase their scale of new markets, members, branches and, preferably, nondiluting capital costs. Member demands for convenience and accessibility, competitive pressures, technological and regulatory changes, and the current economic cycle are coming together like a "perfect storm" for mergers. Mergers provide continuing CUs with instant members, facilities, trained staff and market awareness.

Recognizing the importance of mergers in their overall business plan, many credit unions are allocating significant resources to these expansion efforts. In our work with credit unions seeking merger partners, we see that credit unions dedicated to the merger growth strategy have fine-tuned their process to reflect quality from the initial proposal through merger integration.

We are increasingly asked to help credit unions perform market analysis and identify priority markets on a statewide or multi-state basis. The market entry strategy is often to identify possible merger candidates. In markets with a limited number of credit unions, the competition for the credit union seeking to be merged is often quite high.

WHAT'S BEST FOR MEMBERS?

A merger is the biggest decision credit unions seeking to be merged will ever face. A rigorous RFP process can help ensure they solicit broad interest in their credit union and the market opportunity they offer. When we work with credit unions during this process, we collect valuable information about the market and the credit union's operations to provide credit unions responding to the RFP adequate data on which to make a proposal. RFP responses must be carefully analyzed to provide a foundation for this critical board decision.

Our experience also indicates that CUs use different criteria to decide whether a merger opportunity merits their consideration. Many continuing credit unions perform a cost-benefit analysis of the merger opportunity. We have talked with CUs that set an asset threshold of $10 million; below that range, they consider a merger more as an act of benevolence than as a strategic growth opportunity.

Smaller CUs considering a future merger as a way to offer the services and delivery channels their members want and as an avenue to tap into their market potential need to begin positioning themselves for that eventuality. This entails building financial strength, ensuring good loans, avoiding detrimental contracts and making smart facility decisions. These sound business decisions benefit members and enhance leverage in negotiating with potential merger partners.

Manchester-based Telephone Credit Union of New Hampshire (*www.tcu.org*) completed its first merger in its 83-year history when it welcomed members of Greater Nashua Federal Credit Union into its fold in February. President/CEO Michael L'Ecuyer says the merging credit union approached Telephone CU, which has $218 million in assets and 13,200 members.

"It was very well capitalized but did not have the financial resources to effectively provide the services to meet members' needs," notes L'Ecuyer, a CUES member. "Mergers are not part of our credit union's growth plan—we rely on organic growth. But we looked at this merger as a way to help a credit union continue to provide value to its members. At the same time, this merger provides us growth and allows us to keep the critical mass growing."

In assessing prospective merger partners, Bob Corwin, executive vice president at $1.4 billion First Technology Credit Union, Beaverton, Ore., lists membership characteristics, cultural fit and financial stability as key factors. "Financial health becomes more important as the size of the credit union increases," suggests Corwin, a CUES member. First Tech CU (*www.1sttech.com*), with 125,000 members, recently completed a merger with State Employees Credit Union in Portland.

Credit unions must assess market, financial and organizational issues in choosing a merger partner. In the following sections, we focus on the issues acquiring credit unions should consider in selecting potential merger partners; CUs weighing their options of merging into another organization should conduct a similar assessment to protect their members' interests.

MARKET CONSIDERATIONS

In assessing fit, "it's important that the vision and mission of the credit unions are congruent," Gilbertson suggests. "It is essential to ensure that the credit union you are merging is in a market that you want to be in and that you are willing to allocate the resources to make sure members of the merged credit union are equally well off."

• **Market area**—How well do the demographic and geographic characteristics of the target credit union's market complement your target market? Evaluate such issues as market size and penetration, bank and credit union competition within the market, growth of households within the market, and member demographics, such as home ownership, age and income levels. When assessing SEG-based credit unions, examine the size and demographics of the SEG base, stability and potential growth of employment, and branch proximity to SEGs.

• **Branches and facilities**—Are the target credit union's branches in high-visibility, high-traffic corridors? Are they conveniently located and easily accessible for your existing members? Do they offer sufficient capacity and adequate drive-up lanes and parking? Assess financial, security and design conditions of the branches. What merchandising opportunities exist to increase product and brand awareness?

Mergers offer acquiring credit unions opportunities to gain rapid access to new target markets, provide new and staffed branch facilities, gain efficiencies and improve member service.

• **Business strategies and operations**—What services, delivery channels and branch hours does the target credit union offer members, and how is it performing? In our work with credit unions, we've found that relatively simple operational changes, such as expanding branch hours, can increase membership and enhance relationships with existing members.

• **Marketing**—How extensive are the target credit union's marketing efforts, and what marketing channels does it employ? Examine the CU's product mix, pricing and ratio of products per member to see what growth potential exists. What is the brand image and competition in that market?

FINANCIAL CONSIDERATIONS

As the competition for merger partners increases and the resulting costs for buying out target credit unions continues to escalate, a thorough financial analysis is critical. This analysis will assess how much the acquiring credit union is willing to pay and what the return on the investment will be.

• **Fixed assets**—Evaluate the target CU's fixed assets, remaining deprecia-

ble life, existing leases and other contractual obligations, ongoing relevance and potential for liquidation. Compare the market value of its facilities to book value. Can some branches be closed and members more effectively served through the acquiring credit union's branch network? If so, can the credit union achieve gains on the sale of facilities?

• **Earning assets**—Evaluate whether you may be able to generate more productivity out of the target credit union's cash and investments. In particular, assess loan portfolio quality. Are underwriting criteria adequate? How would borrowers' credit ratings be stratified into different segments of risk? Is there adequate security? Do members have sufficient earning capacity? Have loans been priced according to risk, and does the price satisfactorily reflect risk? Has the CU adequately reserved for probable charge-offs? How effective are its collection efforts?

• **Liabilities**—Is the target credit union named in ongoing lawsuits or facing potential legal action?

• **Income statement efficiencies**—In particular, examine the target credit union's fee income and policies and its personnel and other operating expenses for potential improvements and productivity/efficiency gains.

OTHER CONSIDERATIONS

Cultural and political aspects are often at the heart of the most difficult merger discussions. Key issues for the target credit union are board representation, management roles in the new organization and accommodation of staff. In the merger of State ECU with First Tech CU, for example, the State ECU board "wanted to make sure their members would be represented in decision making," Corwin notes.

In the proposed merger of Deere Community CU with John Deere Community CU, future board representation was a crucial issue, Skelton says. "We will have one member represented on the board of John Deere Community Credit Union, and we will set up a local advisory board of five members to be a sounding board for the local community."

In the merger discussion between Greater Nashua FCU and Telephone CU, maintaining a branch in the merging credit union's market area and retaining staff were central concerns, L'Ecuyer says. While the board of the merging credit union did not emphasize continued representation on the Telephone CU board, Telephone CU indicated that its nominating committee would likely select a Greater Nashua FCU director.

• **Governance—**How will the target credit union board and committee structure be incorporated into that of the continuing credit union? Some options include offering permanent board positions, increasing the number of directors temporarily or establishing a market advisory committee as in the John Deere Community CU merger.

• **Management—**Does the target credit union have key management that would benefit the continuing credit union? What type of severance or retirement packages must be provided to gain acceptance for and facilitate a smooth transition?

For example, when Deere Community CU merges with John Deere Community CU, former CEO Skelton will join the senior management team of the continuing CU as VP/strategic planning and development.

• **Staff—**How will staff be compensated? How will their retirements be funded? How will vacations be administered? What are the cultural differences between the organizations? How will change be managed to introduce new employees to the acquiring credit union's culture, products and sales environment to achieve a strong return on the merger investment?

Once a merger has been completed, ensuring a cultural fit for staff and members is clearly a top priority, says Dennis Cutter, president/CEO of $465 million Numerica Credit Union (*www.numericacu.com*), Spokane, Wash. Numerica CU, with 53,000 members, recently completed a merger with North Central Credit Union in Wenatchee, Wash. "Systems and all those other challenges you can make happen, but bringing people together into a single culture takes time and energy," says Cutter, a CUES member.

Resources

Bonus coverage on this topic, "8 Factors of Successful Mergers," can be found at *www.cumanagement.org*. Click on "Article Archives" and then "Operations." Coverage of a recent CUES teleconference on the subject also can be found in this archive.

For more information on what your CU needs to consider before moving ahead with a merger, order the *CUES Complete Guide to Mergers*, available at *www.cues.org*. Click on "Products" and then "Growth and Expansion Products."

Considering a merger? Eliminate the guesswork by investing in a CUES Pacesetter Merger Comparison Report. Find out more at *www.cues.org*. Click on "Products" and then "Finance & Operations Products."

LIGHTEN THE LOAD?

Mergers offer acquiring credit unions opportunities to gain rapid access to new target markets, provide new and staffed branch facilities, gain efficiencies and improve member service. The relatively small size of some CUs is forcing them to consider merger in the face of increasing competition from banks and larger financial cooperatives. But, even large efficient credit unions are recognizing the strategic value of mergers. These organizations see the importance of critical mass in making gains to compete in the rapidly changing financial services industry. Even the largest CUs in the country face constraints in competing in a financial marketplace dominated by banking giants.

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