More For Members:

Credit Union Leaders Plan Post-Pandemic Merger & Acquisition Strategies

Part Two: Undertaking the Merger Process

To provide the best and most relevant guidance, 25 credit union executives and board members whose experience with mergers provide insights on the process.

What Do Credit Union Leaders Need to Know?

DDJ Myers
Advancing Leadership Success

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Introduction

Having experienced a drastic slowdown in mergers during the throes of the worst pandemic in a century, M&A activity in the industry is widely expected to accelerate during the remainder of 2021. Mergers that were put on the back burner during 2020 are becoming top priorities again.

One impetus for mergers in the credit union industry is the retirement of CEOs, and there's a likelihood that these top-level retirements will become more prevalent over the next couple of years. CEOs who put off retirement during the pandemic-induced economic crisis may feel they've guided their organizations through the storm and are in a better position to step down. Other CEOs may be accelerating retirement plans due to the exhaustive efforts of leading their organizations through this once-in-a-lifetime pandemic. As these credit unions grapple with the massive undertaking of CEO succession, the optimal solution may be to find the best possible merger partner to take on the leadership role.

Still, other credit union leaders may be fast-tracking their pursuit of a merger because their organization would be hard-pressed to afford the transformation to digital delivery channels that their members have embraced and are likely to keep embracing in the post-pandemic era. Rather than leave their members with fewer product services and delivery options than their better-financed competitors, they may seek out a merger partner that has the capacity to meet heightened consumer expectations in our more technologically connected world.

Many mid- to large-sized credit unions will be receptive to merging with smaller credit unions and even smaller banks, realizing that their best path forward is to achieve greater economies of scale that will allow them to better afford investments in the technology, people, processes, and marketing programs, as well as stay viable amid a field of well-financed competitors.

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As merger activities ramp up, credit union boards and executives will need to refine their merger strategies. They'll need to understand how to identify potential merger partners, start potential merger conversations, and move from merger talks to merger action.

DDJ Myers has prepared this white paper to help credit unions devise a game plan for approaching merger strategies in the post-pandemic age. In an effort to provide the best and most relevant guidance and advice, we reached out in early 2021 to nearly 25 credit union executives and board members whose experience with mergers provided them with insights on the process. They graciously agreed to share their insights into the best practices for moving forward with a merger. Collectively, they have top-level experience in developing merger strategies for their credit unions and understand why it's beneficial to proceed with a merger and, in some cases, why it's not.

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REFINING MERGER STRATEGIES

Consideration of merger possibilities often arises in the context of strategic discussions. Kirk Kordeleski, executive benefit consultant with OM Financial Group (om-financial.com), observes, "There aren't many credit unions across the country that don't want to acquire another financial institution. Across asset sizes, everyone's strategic plan talks about acquisition."

That doesn't mean the institutions being eyed as potential merger partners are always eager to jump into those conversations. Kordeleski imagines a conversation among the board members and executives at a $500 million credit union about approaching a $50 million financial cooperative in their market. "They're having a hard time serving their members. Let's just start a conversation and share how their members can be served with more branches, more ATMs, a broader range of skill sets, more lending products, and better pricing. They'll jump on board."

At the same time, if a $5 billion credit union came to that $500 million institution with the same proposition, those same leaders would likely dismiss the notion and respond, "No, we're doing well."

In short, he contends that many potential mergers stall over an honest assessment of the question "Are you providing a significant member value proposition?" To truly optimize member value, credit unions need to be willing to consider merging as well as acquisitions.

> "Are there synergies between these two organizations to develop and unlock unparalleled value to our member owners?"
>
> **David L. Tuyo II**

The CEO of University Credit Union (UCU), Los Angeles, California (www.ucu.org; approaching $1 billion; 45,000 members), David L. Tuyo II, agrees that many credit unions pursue merger opportunities with the expectation that they will be the surviving institution.

"But it shouldn't be about who the survivor is, who the CEO is, who the board chair is. It should be about: 'Are there synergies between these two organizations to develop and unlock unparalleled value to our member owners?'" he says. "If the answer is no—if it's just going to be the same products, services, and rates—then I would argue that merger is not accretive and should not be done. If the answer is yes, it's the fiduciary responsibility of the board and leadership team to find a way to make that work."

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Tuyo recommends the foundation of those discussions to be defining the value of the merger in writing to make it a sustainable, actionable plan. For example, for credit unions in some markets, expanding the branch network would benefit members, but for other financial cooperatives, widening branch access no longer represents a significant benefit for wide swaths of members who favor digital channels.

UCU offers a specific and quantifiable value commitment: “We guarantee our members rates [for the most utilized loan and checking products] in the top 1 percent in the country, and Standard & Poor’s stamps that guarantee,” Tuyo says. “If other credit unions find that to be attractive in adding value for their members and they can’t get to that point due to constraints in their own business, then we would be a good partner for them.”

“But if there’s a larger credit union that could help us get to the top half-percent in value, then we should consider on behalf of our member-owners whether that is doable and sustainable over time,” he adds.

An often-underlying and sometimes unacknowledged aspect of the reluctance to consider a merger is the difficulty executives might have in seeing where they would fit over the long term in the continuing organization.

OM Financial Group is among the business partners that work with credit unions to structure compensation for leaders “to clear the path of self-interest so they can more objectively consider merger possibilities,” Kordeleski says. Some boards that have acknowledged the likelihood of a merger in their future are structuring supplemental executive retirement plans (SERPs) for their leaders. In other cases, some continuing credit unions have adopted an approach to pay a multiyear consulting fee to one or more top officers of the merging credit union as “a financial reward for the business and brand they’ve built.”

Those compensation strategies may become more common as $1 billion-plus credit unions look for ways to draw potential merger partners in the $500 million range to the table. Kordeleski contends that by putting self-interest aside, the leaders of such credit unions can take a more objective view of their market position, which may be eroding over time with the dominance of mega-banks and the emergence of fintechs.

Another issue that should be considered in those honest assessments is talent, Kordeleski adds. To compete in today’s financial marketplace, credit unions need top-notch financial analysts, marketers, data analytic and business intelligence specialists, technology wizards, and executives who can lead their organizations through cultural change. Larger credit unions can more effectively compete for that talent than their smaller peers.

Additional primary considerations in developing merger strategies include (1) calculating the likely return for investing the necessary resources in the merger process and (2) widening the view to include bank acquisitions.

Kinecta-Xceed Merger Realizes a 'Strategic Imperative'

For leaders of the $900 million Xceed Financial Credit Union, doing what's best for members meant acknowledging that consolidating with a larger organization was a "strategic imperative," says Teresa Freeborn, who moved from her role as Xceed's CEO to become president of Kinecta Federal Credit Union (Kinecta), Manhattan Beach, California (www.kinecta.org; $6 billion; 300,000 members) through a recent merger with that now $6 billion financial cooperative.

"Xceed could have continued operating for many years to come, given its strong capital position. However, our fiduciary and moral commitment to members' best interest caused us to conclude that continuing as an independent credit union would have been a disservice to our members," Freeborn says. "Without growth and stronger profitability, we weren't able to innovate, invest in the latest technology, provide compensation packages to attract talent, and expand our team with the deep expertise needed to compete effectively in the marketplace, while offering members the most competitively priced products and services."

With that decision made, the search for the right merger partner—"where the culture, values, and fit would be good for both credit unions and their members," Freeborn says—led Xceed to begin discussions with Kinecta in late 2019.

From the continuing credit union's perspective, this merger presented a range of advantages beyond scale, including "a large pool of experienced, talented employees who [could] be a great asset to the organization" and executive and board leadership providing "an influx of new thinking and new perspectives," says Kinecta CEO Keith Sultemeier.

A complementary branch network will allow the combined organization to enhance service and access for its members and to expand its geographic reach in pursuit of regional growth, Sultemeier adds. The merger partners were headquartered within three miles of each other in the South Bay area of Los Angeles County, but Xceed had east coast branches as well, including several offices in Rochester, New York. As the nation's 35th-largest financial cooperative, Kinecta will now serve members with 32 locations.

The merger officially took effect on April 1, 2021 following approval by Xceed members, with 83 percent favoring consolidation in late February. "The actual integration will take us through most of this year—with systems conversions and rebranding," Sultemeier notes. "We have hundreds of pages of merger transition plans, with the hopes of anticipating every possible hiccup, but we are staying flexible with the expectation that there will be some surprises along the way. The North Star throughout the transition will be what's best for members and staff."

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Kinecta-Xceed Merger Realizes a 'Strategic Imperative'

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The decision to structure Kinecta's leadership with Sultemeier as CEO and Freeborn as president was made in part to recognize the latter's commitment to stay on with the continuing organization for several years. "That gives Xceed's members confidence that the merger is a good idea and that Xceed members and associates will be a priority going forward," Sultemeier notes.

Sultemeier's role as CEO remains largely unchanged, while Freeborn has joined the executive team as a key policy and strategic advisor over a variety of activities, including mergers and acquisitions, government relations and political advocacy, and engagement across the credit union movement and within the Kinecta community. Her role also encompasses member advocacy and close collaboration with other executives to help them formulate and execute key strategies and business plans.

In bringing together the leadership teams of the merger partners, two Xceed executives who had planned to retire have agreed to stay on for a limited time to help ensure a seamless transition, Freeborn says. "Others, like most other Xceed associates, have been pleased to accept new positions with Kinecta. These are solid career moves for them, involving more responsibility and scope since they're now part of a much larger credit union."

In the short term, 50,000 new Kinecta members are looking forward to expanded services such as Saturday hours at branches and more advanced digital banking options, says Roni Crichton, one of two Xceed directors who joined the continuing credit union board, which expanded from seven to nine board seats. "Overall, we expect the economies of scale from being part of a much larger credit union will lead to even greater value, in terms of loan and dividend rates, fees, new services and technologies, and so on."

Kinecta Board Chair Mary Yasui-Yamabe notes that the greatest hope of the continuing credit union is "that the new members we welcome to our credit union family will be so thrilled with their decision to partner with us that they deepen their engagement and—if it isn't already the case—that they and their family members make our credit union their primary financial institution for generations to come."

From the perspective of merging credit union, Crichton responds, "the greatest hope is that our due diligence was as thorough as we believe it to be—essentially, that the fit between us and our merger partner is as fantastic as we believe it is and that all of the great things we believe are in store for our members come to pass."

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Aiming for Scale

Over the last 12 years, Connexus Credit Union (Connexus) in Wausau, Wisconsin (www.connexuscu.org, $3.3 billion, 385,000 members) has completed eight mergers, ranging from a very small Wausau city credit union with two employees that the larger financial cooperative had supported with loan processing to its biggest merger to date in 2014, when the then-$350 million Minnesota-based Endura Financial Federal Credit Union joined the then-$640 million Connexus.

Building on what it has learned from those past mergers, the Connexus executive team in early 2021 developed and presented to the board high-level guidelines for future merger candidates.

“We’re in the mode to be looking, but we’re at a point now that we’ve done enough mergers to recognize the substantial investment involved,” says Board Chair Ron Dins. “Whether it’s a $100 million credit union or a $400 million credit union, the amount of work is similar, so we want to be looking in the $300 million and up range for forward-thinking credit unions with strong member focus, a similar employee-centric culture, and a balance sheet that we can improve with our areas of strength.”

The pursuit of mergers is one of three primary growth strategies at Connexus, behind a strong indirect lending program and organic growth, the latter of which is challenging in a saturated market, Dins notes.

Having passed the $2.5 billion mark in assets, JSC Federal Credit Union (JSC), Houston, Texas (www.jscfcu.org; $2.6 billion; 135,000 members) is committed to doubling that figure by 2025 with an initiative called “5-by-25.” The credit union is making a multi-million-dollar investment in technology and infrastructure to support the initiative and will seek out merger partners as part of its strategic plan for growth.

Former President/CEO of JSC, Brandon Michaels, says, “We’re primarily looking for credit unions with assets of $500 million and above, but if a deal made sense in a good market with a partner in the $250 million range, we would definitely consider it”.

Mergers provide both partners—the merging and continuing credit unions—with the advantage of scale. “Our partners also get the advantage of becoming part of a purpose-driven organization that thinks big but acts small,” Michaels says. “They would become part of a hyperlocal, tech-centered, member-centric organization that is dedicated to improving people’s lives.”

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Kris VanBeek, President/CEO of USALLIANCE Financial Federal Credit Union (USALLIANCE), Rye, New York (www.usalliance.org; $2 billion; 120,000 members), reports that USAlliance has become more discerning about the threshold for proceeding with a credit union merger. “As a $700 million credit union, moving forward with the merger of a $40 million credit union made sense,” he acknowledges. “At $2 billion, it makes less sense. If we’re originating $50 million or more in new loans every month, is a $20 million merger really worth it?”

In some cases, the answer could be yes—for instance, if another opportunity came along to merge with a $40 million credit union with growth potential among the expanded field of membership. If such potential doesn’t exist, VanBeek sees investing in new products and services as a better path forward for achieving growth.

Along the same lines, Barry Shaner, President/CEO of Directions Credit Union in Toledo, Ohio (www.directionscu.org; $1.1 billion; 110,000 members), observes that the requirements for merging a $50 million credit union are not significantly different than those for an organization four or five times that size. Regulatory approvals must be sought, systems and accounts must be converted, and member communications about the merger as well as information on and support in navigating new systems and channels must be provided.

“All that disruption comes at a cost. It’s not always easy to quantify, but there is definitely a cost,” he says. “There are lots of reasons to do a merger—sometimes just because there are members who need help. But we do have to analyze the financial costs and benefits in terms of the new business we’re going to attain.”

Part of that calculation should encompass whether it’s possible to achieve the same results with less investment of resources, he adds. “At our current size, a $50 million merger represents 5 percent annual growth. Could we achieve 5 percent growth in another way, perhaps with a big marketing push?”

“Who they serve and how they serve”—a credit union’s field of membership and corporate culture, respectively—are the most important filters for UCU’s leadership team in assessing prospective merger partners, Tuyo says. But if a credit union is smaller than 10 percent of UCU’s asset size, that disparity will make it more difficult to justify—without an extraordinary potential for growth and SEG expansion—because the larger credit union is growing at that rate annually without committing staff time and resources to a merger.

Brandon Riechers, CEO of Royal Credit Union (Royal), Eau Claire, Wisconsin (www.rcu.org; $3.5 billion; 226,000 members), has heard the argument from peers that a merger of a smaller credit union requires as much work as a larger transaction. His response: “We just have a bit of a different take on that. There’s a lot of truth to the

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fact that it costs the same to go through a $100 million merger as a $500 million or $1 billion merger, but if you go through a larger merger and find that it's not as good a cultural fit, the growing pains in years 1, 2, and 3 are much greater and can impair continued organic growth during the transition."

Size alone does not ensure a credit union will benefit from economies of scale, Steve Ewers, President/CEO of Members Cooperative Credit Union, Duluth, Minnesota (www.memberscu.org; $950 million; 55,000 members), cautions. "An organization still needs to have the right people, optimized processes, and effective technology in place," he says.

Assessing a Potential Bank Acquisition

Credit unions looking for merger partners need not limit their search to other financial cooperatives. In fact, Royal has done more bank acquisitions than credit union mergers in recent years. Those transactions have tended to be more straightforward, with discussions focused on purchase price and more leeway in determining which employees will join the continuing institution, Riechers says.

Another factor that tilts toward acquisitions over mergers is availability. "The Midwest as a whole has more community banks than anywhere else in the country, with the exception of Texas," Riechers notes. "A lot of community banks in these regions are making determinations every day based on succession planning and other factors about whether they want to keep going or sell. They're making a financial decision: 'Now is when we'll get the best value.' By that point, they've cut ties from an emotional point of view."

Though many credit unions pride themselves on their commitment to their members and community as a market differentiator, Riechers notes that some community banks have similar philosophies—and face the same competitive pressures from mega-banks. Royal has partnered with community banks on participations in commercial loans.

"Some of these banks are as invested in their communities as we are," he notes.

Bank acquisitions may arise through introductions from third parties such as law and accounting firms, where bank leaders seek valuations and brokers to help arrange their intended sales.

Royal has succeeded in turning many bank customers into credit union members through those transactions, largely by offering value through better rates and lower fees. It helps that those consumers still see familiar faces at their local branches, Riechers adds.

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“As long as it’s just a change in signs outside, it comes down to our value proposition and people. It’s important that any employees retained in an acquisition, however, reflect Royal’s values and are able to meet the expectations Royal has for their team members. That’s why Royal applies the same approach to determining whether existing employees at an institution it acquires are a fit for Royal as it does when hiring new employees.”

GreenState Credit Union (GreenState), North Liberty, Iowa (www.greenstate.org; $7.1 billion; 250,000 members) acquired several central Iowa branches, including assets totaling $500 million and the continued employment of about 100 staff members, from First American Bank in 2020. The credit union was approached by a broker about the bank branch acquisition in 2018. Jeff Disterhoft, President/CEO of GreenState, says that at the time, the credit union was not proactively seeking M&A partners, but its leaders recognized—and have since realized—the potential for this transaction to step up its service delivery on several fronts. The credit union has been able to extend treasury management for commercial members and trust services to its wider membership through the bank acquisition by deploying the talents of specialists in those product lines.

In addition, its new branches in the Des Moines area are equipped with automated video tellers. In the not-too-distant future, members will likely be able to use their smartphones for video interactions, but especially during the pandemic, the video tellers have offered “an efficient delivery mechanism that expands how we serve members,” Disterhoft says.

In the aftermath of the bank branch acquisition, GreenState has become more proactive on the M&A front and has put teams, including legal specialists and brokers, together to scout for similar arrangements with banks and credit unions. “We’ve delineated those responsibilities within our organizational chart as well, so we have one individual who helps me focus on the credit union mergers and another individual who helps with bank acquisitions because the two transactions are fairly different and the courtship is dramatically different,” Disterhoft explains.

GreenState agreed to buy two banks, as reported by Ken McCarthy for the American Banker in his article “Iowa Credit Union’s Takeover of Two Banks Riles Industry,” on May 25, 2021. The acquisition of Oxford Bank & Trust, $730 million in assets, located in Oakbrook, Illinois, is expected to close in the fourth quarter. In addition, the acquisition of the Premier Bank, $345 million, in Omaha, Nebraska, was also announced by GreenState.

Bank acquisition tends to be a straightforward bidding process in which the most aggressive bid stands the best chance, Disterhoft adds. Credit unions may have an

advantage in bidding for community banks because they come to the table as all-cash purchasers; offering stock to finance the acquisition is not an option.

There are a lot of assumptions about how the members-first philosophy of credit unions and profit-oriented purpose of banks filter down in their respective cultures. In the GreenState bank branch acquisition, "we found those assumptions whole-heartedly to be the case—and it couldn't have worked out any better for us," Disterhoft says.

"On the credit union side of things, it's more a matter of the heart. The relation-ships we form without our industry matter a great deal. And how we take care of our members, employees, and communities matters a great deal," Disterhoft notes. "Those factors become a foremost interest for everyone involved, which makes the process far more nuanced."

> "If you take good care of your employees, they're better positioned to take care of your members— and that's been the case for us."
>
> **Jeff Disterhoft**

Retention of staff of the acquired bank branches has been high, and engagement scores among those employees have been "among the best we've seen," as have their member service levels, as indicated by Net Promoter Scores at those loca-tions. Disterhoft suggests that that pattern demonstrates an often-touted credit union tenet: "If you take good care of your employees, they're better positioned to take care of your members—and that's been the case for us."

He adds that merging with a financial institution that may not have the strongest service culture can be a win-win situation "because you can show those employees a better way through a values-based culture that really strikes a chord with them."

That's not to say that it's always easy for incoming employees to transition to the culture of the continuing credit union. "It's still a change, which can create some consternation. They were very acclimated to a more hierarchical chain of command, whereas our culture is a little bit more empowering, a little less regimented, a little more entrepreneurial," Disterhoft says. "It wasn't a lengthy process, but it did require some adjustments."

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Five Ideas on Paving the Way for Merger

1. Start by building trust.

"Credit union mergers tend to take more time through building relationships between CEOs, finding a comfort zone, and figuring out if the cultures are compatible," says Riechers. "Oftentimes, building trust through those relationships begins when times are good, and then when the going gets rough, colleagues are more comfortable talking through the challenges. Deals have been struck on first meetings, based on first impressions, but more often, they happen over the long term."

2. Lend a helping hand.

In positioning Pen Air Federal Credit Union (Pen Air), Pensacola, Florida (www.penair.org; $2.1 billion; 115,000 members) for merger discussions, "we have to first make ourselves known as good partners in the region," says Board Chair Bob Jacobson. The credit union has supported smaller financial cooperatives in serving their members in the aftermath of hurricanes in recent years through shared branch availability and a loan of the "bus"—its mobile ATM—to financial cooperatives with branches temporarily closed by a storm or other emergency. Pen Air has also offered to share staff and office supplies and assist with food delivery to communities during natural disasters.

3. Provide expertise and business support.

One credit union has established a CUSO to deliver commercial underwriting services to smaller financial cooperatives in its region, which may pave the way for future conversations about a potential merger.

4. Offer systems solutions.

If member service and market challenges are steering credit unions toward entertaining merger offers, technology issues can firm up such a decision, suggests Simon Walton, Board Chair of USAlliance. "If a credit union is locked into an old core system that can't grow and take on additional volume, then you're looking at a substantial investment to add scale to the organization."

5. Steer clear of "cold calls."

As a board official for a Midwestern credit union notes, "You don't just call someone and say, 'Hey, I think we should merge,' and the other party says, 'Yes, that's a great idea.' That just doesn't happen. You have to build that relationship."

Sultemeier concurs. The benefits of consolidation may seem obvious to the leaders of prospective continuing credit unions, but that doesn't mean proactive recruitment of potential merger partners is an advisable approach.

"If you're the CEO of a potentially acquiring credit union and just pick up the phone and start dialing for mergers, people don't really like that," he says. "If you're the CEO of a credit union and think you're doing pretty well right now, if you're not really receptive to a merger—right, wrong, or indifferent—that's not really a call you want. Usually, the leaders of the acquired credit union take the first step because they have the most risk."

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MOVING FROM MERGER TALKS TO ACTION

A variety of factors will drive merger conversations forward. For merging credit unions, financial and market-driven concerns are likely near the top of the list. Shawn Gilfedder, President/CEO of Kitsap Credit Union, Bremerton, Washington (www.kitsapcu.org; $1.7 billion; 115,000 members), identifies three key elements to consider when determining whether to proceed with a merger: scale, scope, and the relevancy and sustainability of the business. "In terms of scale, asset size brings levels of efficiency to your business that you might not be able to obtain as a smaller credit union," he says.

In terms of scale, asset size brings levels of efficiency to your business that you might not be able to obtain as a smaller credit union, says Shawn Gilfedder.

Scope, meanwhile, takes into account talent and technology. "The burden of regulatory requirements continues to weigh heavily on institutions, as does the ability to adopt emerging technologies that allow your business to become more efficient," Gilfedder says. "There are limiting factors on your abilities in these areas based on the size of your organization."

The question of relevancy and sustainability is something that credit unions across the industry will need to answer, Gilfedder continues. "If your member base is aging, and you're losing opportunities for growth, then it really presents challenges for your organization. You have to ask yourself, 'What is the future viability of our business going forward?' and, 'Where do we stand in an industry that is consolidating?' Those are difficult questions for boards and leadership teams to answer, but those are the types of discussions they should be having."

Overcoming Obstacles

Proceeding with a merger may make practical and logical sense for all parties involved, but in some cases, emotional issues can thwart the best course of action. Such factors as fear of the unknown, the egos of board members or senior

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executives, or a sense of loss may play a role. Credit unions ignore such potential sources of conflict at their own peril.

"The greatest hope is for a seamless merger that produces overall value for the new organization," Ewers says. "Integrating cultures, no matter the size of the organizations, is critical. However, I've seen cultural conflicts in mergers present serious challenges and barriers."

Such factors as pride, ego, and disagreements about staff and board leadership are potential points of contention. Ewers stresses the importance of ironing out these issues up front.

> Operating a subsidiary under the merging credit union's name for a period of time is an option, per Reichers.

"It's almost like dating," he observes. "Both credit unions should like each other and have similar cultures—if they don't, the marriage of the two organizations is starting on a rocky foundation."

In fact, several executives likened the lead-up to a merger as a courtship process—and the eventual merger itself to a marriage. As in a marriage, Matt McCombs, President/CEO of Vibrant Credit Union (Vibrant), Moline, Illinois (www.vibrantcred-itunion.org; $970 million; over 50,000 members), observes that the two partners who have come together agree on the "big things," such as shared values. "The bigger things tend to be easier to figure out up front," he says. "It's the ongoing little nuances—what people do and how they do them—that are hard to describe until you go through the process that can determine how successful the partnership will be."

The biggest obstacle may be fear of the unknown, Riechers says. For the potential merging credit union, executives and board members worry about the impact on members of losing a brand name that they associate with a SEG or affinity con-nection. To address those concerns, Royal executives have had discussions about operating a subsidiary under the merging credit union's name for a period of time.

Another option is extending an employer partnership program offered to certain businesses, which would offer benefits to members of the merging credit union for joining Royal. That program could provide additional reassurance to the leaders of the merging credit union that their members are being treated with care—and at the same time help Royal expand its new member base.

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Michael Lussier, President/CEO of Webster First Federal Credit Union (Webster First), Worcester, Massachusetts (www.websterfirst.com; $1.2 billion; more than 100,000 members), acknowledges that many credit unions have a fear of mergers, with some boards being reluctant to pursue one because they consider it an admission of failure. “Nobody likes to give up the ship, but nobody wants to go down with it either,” he says. “Sometimes, in an ill-advised move, boards will attempt to survive another year so that a merger doesn’t occur on their watch.”

Nobody likes to give up the ship, but nobody wants to go down with it either, says Michael Lussier.

For credit unions that are failing, mergers represent a pathway to regaining their financial standing. “A lot of credit unions that are merging are CAMEL 3, 4, or 5,” says Lussier. “We’re a very strongly rated credit union, and I can tell other credit unions, ‘The day you merge with us, you’re also going to be a better-rated institution as well.”

A succession of strategic mergers can be an effective pathway to growth for many credit unions. However, McCombs cautions against proceeding too quickly with a merger strategy. “Sometimes the heart can get ahead of the brain, and you have to be careful about spreading yourself too thin,” he says.

At Vibrant, McCombs notes that the standard for proceeding with future mergers will be “whether we can make an impact and be the best potential partner we can be. If the answer is no, then we probably need to sit on the sidelines.”

To guard against overextending itself beyond the organization’s capabilities, Vibrant has stepped back from mergers for a few years. “We had to be reflective and ask ourselves, ‘How can we be cognizant in ensuring that the value we are offering is truly for the collective good?’” McCombs reports.

Addressing the Sense of Loss

The strong community ties of smaller credit unions can hold their leaders back from merger discussions over concerns about the detrimental loss of a local presence in a marketplace. “Those credit unions can react faster to market conditions because they literally live and breathe in that environment,” Kordeleski notes.

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Many credit union leaders “care deeply about their nonprofit mission and truly believe in the importance and value of the cooperative model of credit unions,” says Kinecta Board Member Roni Crichton. “They recognize the real value that comes from being member-owners of our financial institution rather than simply customers of a bank. That’s why I think that, for the most part, resistance to considering a merger springs from concern about losing those essential values. And that’s why it’s so important to perform exhaustive due diligence to ensure there’s a good cultural fit between the credit unions.”

Executives and directors alike may also need to let go of “outdated thinking about the notion of being ‘acquired,’” Crichton suggests. There is a perception that merging amounts to a net loss rather than a gain for members.

“I would argue that our moral and fiduciary duty to the members we represent requires us to face the world as it is—not how we might like it to be—and to make the bold strategic decisions that are in our members’ best interests,” she adds. “Sometimes those are tough calls, but good leaders have to be able to make tough calls and do the exploratory work that is needed to assure members that all the options have been explored and that this is indeed the best path forward.”

Pat Zollars, former Chair of Telhio Credit Union (Telhio), Columbus, Ohio (www.telhio.org, $960 million, 35,000 members), acknowledges that the sense of loss in many merger situations can be quite profound. “Both sides feel they are losing ‘their’ credit union, ‘their’ relationships,” he says. “Members from both sides may be nervous or apprehensive about leaving something that is comfortable and going in a new direction.

Telhio has navigated several successful mergers by emphasizing such positive benefits as the ability to provide a broader and better product offering as well as more convenience to the member, Zollars notes.

Many boards have directors who’ve developed a deep pride in and emotional attachment to their credit unions in their decades of volunteer service, which can make it harder for them to assess objectively the member benefits of a potential merger.

Overcoming that reluctance requires building trust that the most important aspects of putting members first will be preserved and inspiring confidence that the merging credit union is handing off member service “into other people’s good hands,” Walton says. The PepsiCo credit union directors and manager walked away from discussions with a couple prospective merger partners, with a broad consensus that those organizations did not share their member service commitment, before agreeing to the merger with USAlliance in 2015.

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Completing that agreement entailed "an interesting series of conversations" with the merging credit union's long-time manager about her retirement and the negotiation of a three-year continuation of jobs, terms, and benefits for its employees. "Having done the right thing for the staff, they were happy to tell the members they served that this was a decent arrangement and they were OK, and that helped deliver a 95 percent member vote in favor of the merger," Walton says. To overcome the sense of loss that occurs when a familiar credit union brand leaves a community, Michaels recommends that the combined credit union work to fill the void by aligning around a common purpose of serving the community that incorporates the previous credit union's priorities and commitments.

"Strategically, that could entail reconfiguring a new corporate social responsibility program that blends the perspectives and passions from both organizations," Michaels suggests.

Ensuring a Good Fit

Ensuring compatibility between prospective merger partners is a prime consideration, but the definition of fit encompasses a variety of factors. Adele Sandberg, President/CEO of AEA Federal Credit Union (AEA), Yuma, Arizona (www.aeafcu.org; $300 million; over 32,000 members), notes that fit can describe how a prospective merger partner's goals and objectives reflect the credit union's strategic plan. This assessment might also address geographic components—i.e., the size of the credit union and its locations within and across a given market.

"For example," Sandberg says, "I'm in a rural community, so I would probably be more inclined to go into other rural communities because we know how to serve them and to serve them well."

AEA merged into one credit union several years ago that resulted in a branch location in nearby Parker, Arizona. However, Sandberg says she is amenable to future mergers, either as the continuing or merging credit union. "You have to put your ego aside and make the best decision for the member," she says.

In many cases, the subject of fit revolves around the topic of culture—ensuring that the two organizations share some philosophical tenets and are driven by the same type of mission, purpose, and values.

"I think if you're looking at a merger opportunity, you have to be mindful that two institutions are coming together, so you need to consider what that is going to look like from a culture perspective," Sandberg adds. "If you have clashing cultures, it's going to be pretty difficult and maybe even disruptive to the smooth operation of the credit union."

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Riechers is a proponent of the saying, attributed to the renowned management consultant Peter Drucker, that “culture eats strategy for breakfast.” Applying that notion to mergers, he cautions that a cultural disconnect between two institutions could disrupt operations and reduce the expected growth in membership, assets, and revenue.

“We’re a values-based organization, so we’re looking for institutions with aligned values. Any cultural misalignment can be a huge barrier for a merger,” Riechers says.

Assessing culture across an organization can be more art than science, he acknowledges, but on an employee level, Royal applies the same approach to one-on-one interviews with the staff of a merging institution as it does in hiring new employees to evaluate cultural alignment and job skills.

Employee surveys and turnover rates can provide some helpful indicators, but the best assessment of cultural fit is accomplished through personal interactions, Sultemeier suggests. As both credit unions fulfill their due diligence, which he describes as “a process of people getting to know each other and examining the two businesses,” person-to-person discussions are especially crucial for the leaders of the prospective merging credit union.

“They face the harder decision: Is the partnership a good fit? Are the culture and corporate values compatible? Are the types and levels of services they provide consistent with what our members have grown to expect? Can they solve any problems that we might have? Will this be better for our members?” he notes. “There’s more risk for the merging credit union because they only get to do this once, and they have to make sure they make the right choice in partners.”

“You’re asking one board to give up control of a brand in which they are heavily invested to another,” Sultemeier adds. “So, of course, there is great uncertainty. They wonder, ‘Who’s going to be looking out for our members and employees if we’re not here?’”

Sultemeier sums up an underlying, and sometimes unacknowledged, obstacle to considering a merger with the phrase “Not on my watch,” noting that long-term directors don’t want to be on the board that turns over the reins of their credit union to another organization.

“I get it. There’s a lot of pride tied to serving your credit union and members,” he says. “At the end of the day, what those board members want to know is whether the continuing credit union will place the same emphasis on the attitudes and values that have guided their organization. That happens through a process of relationship building.”

How Mergers of Equals Elevate—and Complicate—the Need for Cultural Fit

Mergers of equals and near-equals make most sense for the $2 billion USAlliance Federal Credit Union in the current market and regulatory environment, given the required investment of time and resources, says Walton. “If you’re going to do this, do it at a scale that is worthwhile.”

At the same time, the closer the two merger partners are in size and complexity, the more critical cultural fit becomes, he cautions. If the corporate cultures of two organizations considering a merger are very different, that could slow down the transition and delay achieving the anticipated benefits of consolidation.

Walton describes USAlliance’s culture as “nurturing and supportive,” saying, “We’re growth-oriented. We look for people who are going to make the place better. And we recognize employees who improve the member experience. Merging with a process shop that is focused primarily on transactions and isn’t so committed to technology and the ‘next big thing’ might make it hard to integrate the two teams.”

Walton, whose “day job” is that of an HR executive, cites a variety of quantitative metrics and substantive programs that prospective merger partners can use in assessing cultural fit: support and structure for skills and talent development and career advancement, investment in innovation, staff turnover, member satisfaction ratings and feedback, and tracking of contact center productivity based on solutions shared with members versus time spent on each call, to name a few.

“There are concrete elements you can look at to evaluate culture, not just a squishy gut feeling about whether they’re ‘nice people,’” he adds. “You can get pretty precise and track cultural elements objectively.”

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Forming a Clear View Through Due Diligence

While cultural fit is important, it's essential to determine through due diligence that the merger makes financial and operational sense. Lussier notes that due diligence entails doing an in-depth trend analysis of the potential merger partner's finances, ensuring that they have not overvalued their assets due to insufficient underwriting or high rate of delinquencies, and evaluating key ratios such as net worth and return on assets.

"As you look at the trend analysis, are the ratios going positive or negative?" Lussier asks. He urges credit unions to review their own trend analysis as a means of correcting ratios that are going in the wrong direction. If institutions want to boost their standing as a merger partner, those corrective measures could be extremely important.

> While it may not sink the merger, you need to know if there are any skeletons in the closet, says Bill Birnie.

"If you're proactive, you'll have made changes during those trend analysis reviews to stop those negative trends from occurring," Lussier notes. "Unfortunately, too many institutions are more reactive than proactive. They lack the ability to follow the trends of their key ratios and don't take the corrective action necessary to put better policies, procedures, and strategies in place."

Bill Birnie, President/CEO of Frontwave Credit Union (Frontwave), Oceanside, California (www.frontwavecu.com; $1.09 billion; 111,000 members), stresses the importance of conducting appropriate due diligence to safeguard the assets that the members have entrusted to their credit union. "The capital we've built up is the members' money, and we need to be sound financial stewards of that," he says.

There are many ways a merger can go wrong, Birnie warns, which is why he recommends doing a thorough vetting of any potential merger partner. "While it may not sink the merger, you need to know if there are any skeletons in the closet," he advises. "As I stated earlier, I think culture is critical and, although the financial aspect might look really good, we may choose to pass on a credit union that has a toxic culture. We've worked very hard to build a strong culture here at Frontwave, and a setback like that might take years to overcome."

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Conclusion

Part Two of this white paper provides a strategic game plan for pursuing a merger and stresses the need for a thorough vetting process, but there is one more phase of the merger—the transition—that we will cover in Part Three.

Fortunately, if you follow the advice of our white paper contributors by implementing appropriate strategies for finding the right merger partner, assuring a good cultural fit, and building a strong relationship with the communities that will be served by the newly merged credit union, your transition should go smoothly.

As in every successful business venture, it is key to have the right people in place. You'll need to understand how to undertake rebranding issues successfully, investing enough dollars and resources to establish a new identity and build strong relationships in the community. Ultimately, you will be able to gauge your success by the metrics that best tell the tale of your credit union's effectiveness: employee retention and member satisfaction.

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More For Members:

Credit Union Leaders Plan Post-Pandemic Merger & Acquisition Strategies

Part Two: Undertaking the Merger Process

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