Merging In Uncertain Times: Are You Prepared?

By c. myers corporation

In light of the volatile economy and increasing struggles to stay competitive, with members demanding more convenience, technology and better rates, some credit union leaders are feeling threatened by larger institutions or pressured to compete more aggressively to become larger than peer.

Using sheer size as a decision driver can negatively influence decision makers to execute unsound decisions that result in unprofitable growth—or—can cause a rush to find a merger partner. The inherent dangers are twofold:

- Growth for growth's sake, without considering the quality or implications of that growth, can be a strategy for disaster. Credit union leaders must remember that the size of an institution is not an accurate measure of success or viability—and will not guarantee success in an uncertain future.
- Historically, mergers have a dismal success rate. Popular statistics on the failure rate of mergers and acquisitions prove to be even gloomier than the American divorce rate; as of 2005, about 48% of marriages ended in divorce.[1] Reputable research gauges the merger failure rate of all organizations between 60% and 80%.[2] Cross-industry research indicates that mergers fail due to a number of reasons, strategic and tactical. In essence, executive teams are not investing the proper time and resources in completing due diligence and strategic implementation.

Quite often, merger opportunities present themselves out of the blue, and a potential acquirer has to move quickly. A well thought out merger strategy completed prior to a merger opportunity can maximize the potential for a successful merger—helping to ensure profitable, sustainable growth aligned with the credit union's overall strategic direction.

Merger Strategies: Questions To Consider

A well thought out merger strategy should include answers to the following questions:

[1] Source: National Center for Health Statistics
[2] Source: Strategic Management Research Center, University of Minnesota

Why would we want to merge with another credit union?

Understanding and agreeing upon the decision drivers for wanting a merger can help to prevent internal miscommunication, which can lead to an unsuccessful merger.

For example, some board members may want to find a merger that will make the credit union bigger. The CEO may want to find a merger in order to create an instant presence in a geographic area that is growing fast. The CFO may want to find a merger in order to create operational efficiencies. There is potential for all three of these decision drivers to conflict with each other. Reaching consensus on this question can minimize or eliminate potential conflicts.

Since credit unions are member-owned, consensus discussions that focus on how current members can receive **guaranteed direct benefit** and how potential members may benefit from a merger contribute to a clearer answer. Often this discussion focuses on the benefits from the credit union perspective instead of the tangible benefits for the current membership, resulting in decision drivers that are solely for the potential good of the credit union's operations without in-depth focus on the membership. This can ultimately threaten the long-term success of the merger.

If a potential merger candidate is outside the current market served, it is also important to fully understand the market that would be acquired. Questions to consider include:

- What does the competition look like in the new market?
- How do the demographics differ from the current core market?
- Will the value proposition brought to the current membership be the right value proposition for this new market?
- Where do sustainable growth opportunities lie?

How does the other credit union's long-term strategic vision fit with our credit union's strategic vision?

This question should be asked by acquirers and acquirees alike. Strategic visions should include a description of a credit union's target markets and the value proposition it offers to them.

Imagine the angst that can be avoided if it is discovered in advance that one credit union has a strategy of differentiating itself on price and the other credit union on branch convenience. Few, if any, financial institutions can safely and soundly sustain themselves long term with two expensive differentiations such as these. Stakeholders will need to decide which differentiation will be dominant and calculate the reaction members might have.

What kind of culture does a merger candidate need to have for us to consider them?

Culture was a big stumbling block for the mergers between TimeWarner and AOL, as well as Daimler-Benz and Chrysler. The human element is often underestimated when considering and implementing a merger. In the frenzy to examine business strategies and financial plans, it is easy to place employee and member experiences on the backburner.
Credit union leaders must be able to identify, in advance, the culture they want to preserve, as well as establish a process to understand a potential merger partner's member and employee culture—and how it may be compatible, incompatible, or how it may present manageable hurdles.

The ability to clearly communicate priorities for culture preservation to a potential acquiree can help the acquirer distinguish itself. Keep in mind acquirees often have more than one choice for a merger partner.

<u>Employee Culture</u>
Communication with employees of both organizations is critical; they need to be shown the value that the merger will bring, and how it can directly benefit them.

Issues that may seem simple to credit union leaders, such as dress code, insurance coverage, retirement benefits and organizational structure/advancement opportunities, are increasingly important to staff. Addressing these needs well in advance will help relieve employee anxiety and bolster overall satisfaction. Otherwise, the resulting feeling of frustration and powerlessness can cause strong employees to leave. People want to know what to expect.

<u>Member Culture</u>
It is plausible that the contributing, profitable members of a credit union like its culture, and that is why they give it their business. If they feel that the culture they've come to know is threatened, they may take their business elsewhere. It is vital for acquiring credit unions to understand what it is about the acquiree's culture that their members appreciate. This could be done by reviewing historical product and service use data, past member surveys and conducting blind focus groups.

Identifying potential member concerns and addressing them in advance of the final merger date can go a long way in helping members feel confident in a merger decision, especially with an increased number of financial institutions failing across the country.

Finally, acquiree members will want to know that the process of switching everything to the acquirer will be quick, easy and fair.

What are we willing to give up or promise in exchange for a merger?

When stakeholders involved in merger discussions bring their wish lists to the table, they often conflict.

- The acquirer's wish list may have on it: no board seats for the acquiree and creating operational efficiencies by eliminating redundant staff and branches.
- The acquiree's wish list may have on it: three board seats, a promise to keep all staff and branches, and no name change.

Merger discussions can break down when one or both parties do not consider in advance:

- Their own wish list, how it benefits the membership, and what they are truly willing to sacrifice.
- The potential wish list of the other and how they would respond to it.
- What their top three deal breakers are.

What will our due diligence process look like?

Due diligence includes more than just reviewing financials and a sampling of loans; a good due diligence process is much broader. During the process, many questions should be thoroughly answered. The following are just a few:

- The sum of the parts does not equal the whole—what are potentials for earnings, risks to earnings and risks to net worth of the combined entities?
- Is the credit union heavily weighted in indirect autos and/or one-product members, like CD rate shoppers? If yes, what is the real opportunity for the acquiring credit union? Is it the branch network?
- What has been their deposit pricing strategy, and has it attracted affordable, sustainable liquidity? Are the pricing strategies of both organizations complementary? How would deposit pricing strategy need to change? How might each membership group respond?
- What criteria should be used to represent deposits that will be lost because of the merger?
- Are the two organizations' appetites for credit risk complementary or conflicting? How has appetite for credit risk been managed? Are established underwriting standards adhered to or are there numerous exceptions?
- Are the two organizations' appetites for interest rate risk complementary or conflicting? How much risk does each currently have? What will the combined risk profile look like? Will the combined entities remain within established risk limits if rates and yield curves return to levels like we had in the past?
- How difficult and costly will it be for both organizations to convert to the same I.T. systems? How will the choice of surviving systems be made?
- What contractual obligations with staff must be honored?
- What contractual obligations with vendors must be honored?
- What products and services are offered to members that may be complementary or conflicting, such as reward programs and branch hours?
- If one of the objectives of the merger is to gain economies of scale, how much is needed, and in what timeframe, to ensure the merger is viable? This question is usually not thoroughly addressed; often, it is assumed that the economies of scale will happen. It has been proven across many industries that it does not happen without deliberate, tough and timely decision making.

These questions suggest that an appropriate due diligence team be assembled in advance of any merger opportunity in order to be prepared with adequate processes and procedures for appropriate and timely action.

What will our merger implementation process look like?

Creating a strategic merger implementation framework in advance of a merger can help the process to be more seamless. An implementation team with proper authority, headed by a designated leader and made up of staff from both organizations, can create a sense of cooperation and sharing to expedite the process. Necessary organizational and procedural changes can be worked through and implemented more quickly and smoothly, such as identifying the right "who" to do the "what." The merged staffs will then be able to focus on priorities sooner and return to a higher level of productivity.

The implementation team should treat the merger implementation as a formal project—a project with timelines, objectives, responsible parties, documentation and concrete accountability. There is no reason to risk the alternative of adopting a less formal process that could result in an unsuccessful merger.

What are our contingency plans should the merger discussions fail?

Just like a car, a washing machine or a computer, merger discussions can break down. Often, this can be more of an issue for the acquiree than the acquirer, whether there was an announcement or simply a leak of an intended merger. A merger breakdown can create uncertainty about the future for employees and members who may take steps on their own to create certainty for themselves.

Thinking through, in advance, what steps would need to be taken in the event merger discussions fail will help you to be more prepared so that you can act more swiftly to restore confidence.

Conclusion

Mergers are large in scale on multiple levels: cost, time, staff, duration and the multiple departmental structures involved. Credit unions leaders can reach roadblocks in the merger process by being reactive to issues that arise rather than being proactive and carefully planning and allocating resources.

If you would like to discuss specific issues that relate to your credit union's merger strategy, feel free to contact one of our consultants at: **800-238-7475**.

- Sally Myers, CEO
- John Myers, President
- Rob Johnson, EVP/Principal
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