Managing Success in a Changing World:

Best Practices of Highly Successful Credit Unions

An Executive Briefing for Credit Union Leaders

Summer, 2007

c.myers

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c. myers corporation
8222 South 48th Street, Suite 275
Phoenix, Arizona 85044

Phone: 602.840.0606
Fax: 602.840.7909
www.cmyers.com

Executive Summary

Credit unions face many challenges today. To survive long term, no one can afford business as usual.

To stay current with today's fast-changing environment, and to thrive in the future, credit unions must make changes. But what to change, and how?

The purpose of this executive briefing is to share the conclusions c. myers has reached from its work with credit unions. Since 2000, many events have occurred to stress the industry.

The stock market tumbled, followed by a flight to safety, and interest rates hit almost 50-year lows. Many credit unions converted to community charter.

And advances in technology drastically changed the way consumers and competitors conduct business, especially through online banking and shopping.

The result is that most credit unions urgently need to rethink and update their business models. Changing a business model is never simple; this often means changing what drives business decisions and how success is defined and achieved.

To provide some guidance along this path, this executive briefing has three parts:

Part 1 discusses how rapidly the banking experience is being redefined for consumers, driving the need for credit unions to reassess their business models.

Part 2 discusses the use of traditional measures of success, including return on assets (ROA), current net worth ratio, loan-to-share ratio, asset and membership growth, employee turnover, and comparisons with so-called peers.

Then it shows why the traditional use of each measure may not be relevant today.

What Is A Business Model?

This executive briefing defines "business model" as the way a company decides to run its business.

Some key attributes of this include:

- Value offered to target market(s)
- Infrastructure and organization of the company
- Partners that help deliver value
- Marketing and delivery channels
- Methods used to produce sustainable revenue and profitability.

Part 3 examines the characteristics of today's highly successful credit unions. The key qualitative aspects of managing a successful credit union today include:

- ♦ The reason the credit union exists
- ♦ Effective leadership at the top
- ♦ Clear definition of success
- ♦ Clear goals and strategy
- ♦ Clear definition of the target market
- ♦ Proper balance of risk and results
- ♦ Focus on key strategic priorities
- ♦ A tolerance for mistakes
- ♦ Strategic and creative thinking that goes beyond conventional wisdom.

But highly successful credit unions do not ignore quantitative factors; they still use many key ratios to measure their progress. These include asset and membership growth, a strategic net worth requirement, a healthy operating expense to assets ratio, and a reasonable return on assets.

To move from challenged to highly successful requires executives to take part in a strategic revisioning process, as described in the appendix.

Part 1. The Big Picture: Change is Everywhere

Introduction

Part 1 surveys three spectacular failings in the financial services industry, and what led these once-proud leaders to fall from grace.

The answer: Relying on business as usual, and falling out of step with the competitive landscape.

This part goes on to discuss six key factors that have changed in the business environment for credit unions:

- ♦ New technology
- ♦ Demand for convenience
- ♦ Shifting demographics
- ♦ Lower saving rate
- ♦ A changing talent pool
- ♦ The increasing burden of compliance.

This sets the stage to discuss the traditional measures of success for credit unions in Part 2, and the more effective success factors for today presented in Part 3.

Just carrying on with business as usual, or comparing your institution to your peers, is not enough

The Changing Landscape for Credit Unions

Although they are not-for-profit, credit unions are still in business. And just as in any other business, the changing competitive landscape is a big challenge.

Just carrying on with business as usual, or comparing your institution to your peers, is not enough.

Every business, including every credit union, must give people a reason to trust them, and a reason to use their services instead of those offered by competitors.

Many banks across the country are responding to these changes with new ways of doing business.

This has created a profound shift in the competitive landscape, a shift which every credit union must acknowledge and adjust to.

Three Sudden Financial Failures

In today's fast-changing environment, there is no security in size, history, assets, or apparent safety and soundness. This harsh reality is confirmed by the following stories of three sudden failures in the financial services industry.

BestBank

Consider the case of BestBank in Boulder, Colorado, one organization that did not quite manage to live up to its name. In NCUA Letter 06-01, NCUA quotes the following from an FDIC symposium entitled, "Why Do Banks Fail?"

"*The American Banker* reported that in 1995, BestBank was 'the best performer among U.S. banks.' Yet the bank failed in 1998, with a projected loss of $223 million to the insurance fund."[1]

As you know, *The American Banker* is a widely read banking industry trade journal. What measures did that journal use to draw its conclusions about the wonderful performance of BestBank in 1995? Some traditional measures like return on assets? Growth? Capital? Loan-to-asset ratio?

New Century Financial Corp.

New Century Financial Corp. was once the nation's second-largest provider of home loans to high-risk borrowers, with $56.1 billion in mortgages signed in 2005. Yet in early April 2007, it filed for bank-ruptcy protection.

AP Newswire said it was "the victim of its own financial missteps as well as pressures felt by its rival lenders."[2]

New Century was among a reported two dozen subprime lenders to shut down recently, struck by a rash of mortgage defaults. These companies were buoyed up by the rising tide of home equity during the real estate boom. But when the boom stalled, many of its borrowers were overextended.

The company immediately laid off 3,200 workers and sought to sell its assets.

New Horizons Community Credit Union

And now for an example straight from the ranks of American credit unions: New Horizons Community Credit Union in Denver, founded more than 70 years ago.

In its 2004 annual report, the chairman wrote, "Our credit union is safe and sound. It has risen to one of the top credit unions in the state." From all reports, the credit union was financially stable.

In the same report, the credit union's president wrote, "our membership survey at the end of the first quarter of 2005 stated that 94% of our responding members would recommend us to their friends." At the time of this report, the credit union was popular with its members.

According to NCUA 5300 reports, for the year 2004 the credit union had grown 14.45%, while achieving a loan-to-asset ratio of 88.6%, a net worth ratio of 12.13% and an ROA of 0.84%. By these financial measures, the credit union was very successful.

Yet less than three years later, in January 2007, the state's banking commissioner said the credit union "can no longer survive as a going concern."[3]

A high number of delinquent loans and indirect auto lending were blamed for the credit union's troubles. Today the New Horizons management has been replaced and it is still being operated by the NCUA.

What Can We Learn?

We can learn from these unexpected financial failures.

The key lesson is this: As the environment changes, success in the past does not indicate success in the future.

Every credit union will face serious challenges at certain times in their life cycles. How well any particular credit union can weather these storms depends on several factors.

C. myers' research has uncovered the following key factors for the long-term viability of any credit union:

- The ability to recognize changing market conditions
- The adaptability of its business model
- The proper ways for measuring success, both quantitative and qualitative.

Part 1 of this executive briefing will focus on the first of these key survival issues, showing how dramatically the marketplace for credit unions is changing.

Parts 2 and 3 examine the traditional and contemporary ways that credit unions measure success.

How Not to Be a Commodity

Now for a more positive story about a business that has gone beyond conventional thinking to score a major success.

In a way, credit unions are retailers who deal with shoppers every day.

On the front lines of dealing with the public, every retailer has to deal with constant change, both in buyer behavior and in the range of products they carry.

Like a growing number of executives in the credit union sector, most people in the grocery profession believe their industry has become commoditized.

Some symptoms of becoming a commodity: Customers are fickle, profit margins are thin, and it's often necessary to "bribe" shoppers to come back to the store with loss-leaders that actually lose money.

But this is not necessarily true, as we can learn from one highly successful niche grocery store, Trader Joe's. By striving to be unique, this grocery chain has differentiated itself from the competition and given people a reason to buy from it.

Trader Joe's estimated annual sales in 2005 were $2.6 billion, or $1,300 per square foot, about twice the supermarket industry average.

How do they do it? According to author Len Lewis, we can identify a number of highly successful strategies in Trader Joe's business model.

These three strategies are directly relevant to credit unions today:

- Take a hard look at existing products, and don't be afraid to drop those that customers don't need.
- Know your customers. Find out about their lifestyles and how you fit in—not the other way around. Ask them what they like and don't like and how you can make things better.
- Pursue innovation. Don't just copy what the competition is doing.[4]

Trader Joe's is serious about changing and adapting its business model to make sure it continuously gives people a reason to buy from it.

Highly successful credit unions are doing the same. To succeed, credit unions must respond by differentiating themselves in what is becoming a hyper-competitive atmosphere.

What is Redefining the Banking Experience?

Many factors are forcing financial institutions to revisit their business models and re-evaluate how they measure success, including:

- New technology
- Demand for convenience
- Shifting demographics
- Lower saving rate
- A changing talent pool
- The increasing burden of compliance.

Many banks are responding with new ways of doing business in these areas.

Although it remains to be seen whether these new business models are sustainable, they do represent a willingness to move with the changing times.

And this creates a shift in the competitive landscape to which every credit union will surely have to acknowledge and adjust to.

More than one-third of U.S. households did some type of online banking in 2006

New Technology

Widespread broadband connectivity has dramatically changed the nature of banking. In fact, 45.9% of American households had broadband access as of the end of 2006, giving them instant access to any Web service.[5]

This is up from just 15% in 2002.[6]

It wasn't that long ago that online banking was not even an option.

Now, according to consulting firm Jupiter Research, more than one-third of U.S. households did some type of online banking in 2006, compared with just 13% in 2000.[7]

And a survey in 2006 by the Bank Administration Institute found that 24% of consumers already prefer to bank online, while 58% still prefer to go to a branch.[8]

The deep penetration of Internet access into American households, and the growing acceptance of online banking, have given ING DIRECT a whole new degree of freedom to ask credit union members for deposits. And it's doing it all without a single brick-and-mortar deposit-gathering branch.

ING DIRECT has targeted a new market segment of people who realize they don't need a branch and someone who knows their name in order to do their banking.

Credit unions today face competitors, new and old, using technology to enhance their products, services, delivery channels, and marketing efforts.

This competitive force must not be ignored. Business as usual may still be an option, but the target market for it is shrinking fast.

Instead, people are voting with their fingers on a keyboard and taking their business online.

In fact, assets in online savings accounts more than doubled—reaching $112.5 billion—between the end of 2004 and the second quarter of 2006, according to Novantas, an industry consultant.[9]

Over the same 18-month period, credit union deposits increased by only 6.7% ($38.3 billion).[10] The conclusion is clear: online banking is growing faster than credit unions.

Of course, credit unions themselves can begin to emphasize online banking.

But this will reduce their opportunities for personal interaction with members, a traditional driver of customer loyalty.

Instead, they will have to find new ways to define their distinction of "good service" and to identify creative ways to cross-sell.

Demand for Convenience

American consumers want convenience. They want results the minute they ask. They want it, and they want it now.

Technology does provide consumers with instant, convenient access to their accounts over the Internet.

Yet for those who still want to use brick-and-mortar branches, more convenience is being provided in innovative ways.

Take Commerce Bank of New Jersey. Listen to how its operations were described as far back as 2002:

American consumers want convenience… They want it, and they want it now

"Commerce is open seven days a week. Typically, the branch offices are open from 7:30 am to 8:00 pm during the week and for most of the day on weekends.

"Gloucester Township is the exception: Because Fridays are so busy, the drive-through window serves customers until midnight—make that 10 minutes after midnight.

"Thanks to the company-wide 10-minute rule, the branches open 10 minutes early and stay open 10 minutes late, an added convenience for early birds and procrastinators."[11]

Commerce Bank is targeting people who are interested in convenience more than just rates and fees.

Whether this strategy is sustainable is not the point.

The point is that if any competitor establishes retail hours like Commerce Bank, it could challenge a credit union's thinking about its own business model, and cause executives to invest considerable time wondering how to respond, if they should do so at all.

Shifting Demographics

It is generally accepted that a large portion of the Hispanic population is under-banked.

Since this is the fastest-growing segment of the U.S. population, Wells Fargo is aggressively going after this market, by making it convenient for Hispanics to do business with the bank.

Through March 2006, the bank had opened over 750,000 accounts using matricula cards from Mexico, and consular cards from Guatemala and Argentina.[12]

Through a partnership with HSBC Mexico, the bank also has the largest distribution channel among U.S. banks for consumer remittance customers in Mexico.[13]

Negative publicity about U.S.-based banks offering services to under-documented people has increased lately, so it remains to be seen if this business strategy is sustainable.

However all this plays out, Wells Fargo, Commerce Bank, and ING have radically changed how they do business. In doing so, they have shifted the competitive landscape for all banking services.

Credit unions must develop a greater understanding of all these challenges, and work hard to differentiate themselves for success in this changing market.

Lower Saving Rate

The original base of loyal credit union members is aging. It is not unusual for a credit union to have 55% or more of its deposits held by people aged 60 or older. It's debatable how much longer any credit union can call these funds "core."

Every credit union should devote time to analyze and monitor their deposits by member age to see a picture of their vulnerability to the age demographic.

This is not such a radical idea. In the late 1990s, GM's Cadillac brand had a median owner age of 64. Sales were down 16% through the 1990s, on top of a similar drop during the 80s.[14]

The Cadillac brand managers saw this age vulnerability and changed the business model to attract a younger target market. GM introduced a sportier-looking vehicle and changed the advertising to appeal to a hipper audience including actors, athletes, and rappers. The results? Cadillac sales are up steadily, and by 2005 the median age of owners had dropped to 57.[15]

Table 1 compares five different credit unions labeled A–E, each of which conducted such studies.

It's easy to see that credit unions A and E should draw up different plans. Credit union E found that nearly three-quarters of its deposits are held by members aged 60 and older, and more than half belong to people over the age of 70.

This table shows that every credit union needs to determine its strategic risk regarding aging members.

Deposits by Age

Excerpt: Percent of deposits by age for select credit unions

	<20	20-29	30-39	40-49	50-59	60-69	70+
A	4%	5%	11%	18%	37%	16%	9%
B	1%	5%	11%	12%	25%	15%	31%
C	5%	2%	5%	11%	18%	26%	33%
D	2%	1%	5%	11%	16%	19%	46%
E	1%	2%	3%	6%	16%	20%	52%

Percentages have been rounded to the nearest whole number.
Selection represents range of outcomes for credit unions studied.

72%

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Table 1. Deposits by Age in Five Credit Unions

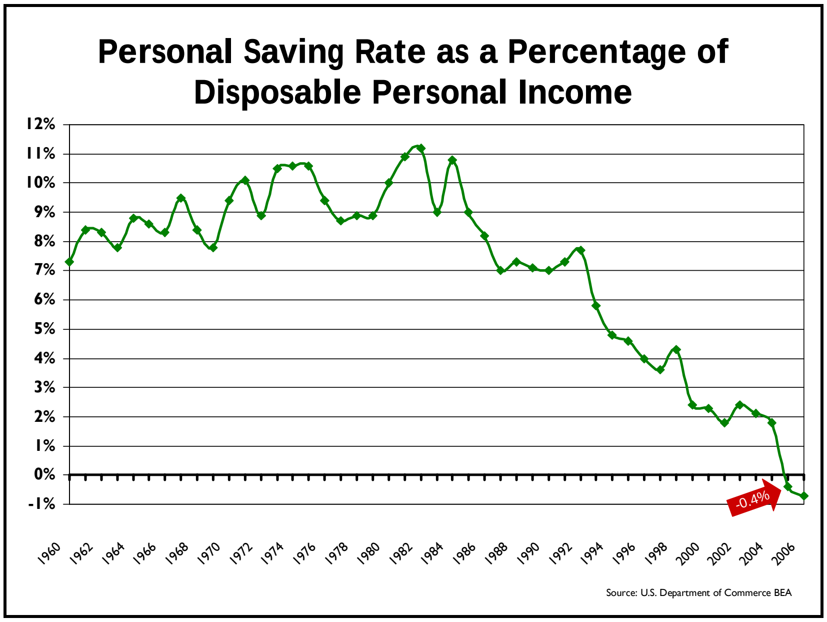


Figure 1. U.S. Personal Saving Rates, 1960-2006

Conventional wisdom invites us to assume that, like previous generations, as Baby Boomers and Generation Xers age, they will save. But evidence is mounting that this conventional wisdom may not prevail.

In 2005, the personal saving rate fell below zero; and it continues to be negative, as shown in Figure 1. This is the first time the saving rate has been negative since the Great Depression.

But that's not all.

U.S. News & World Report reported that "55% of young boomers—those ages 45 to 54—have saved less than $50,000 toward their retirement."[16]

More than half of all young Baby Boomers have saved less than $50,000 for retirement

The story goes on, "Assuming current expectations for Social Security benefits, only around 40% of workers born between 1951 and 1960 are on track to have enough money to cover basic expenses in retirement, based on their current savings and investment behavior."

This alarming situation represents a huge challenge to everyone in the financial services sector, who have the numbers to prove what it takes to live out a comfortable retirement.

This low saving rate has been noted in financial publications like the *Wall Street Journal.*

A recent article confirmed that, "Total deposits as a percentage of assets on hand at the end of September at the country's more than 8,700 insured banks and thrifts reached the lowest level since the Federal Deposit Insurance Corp. was established in 1933."

The article went on to say, "Consider that in 1989, U.S. households deposited 30% of their financial assets in banks… By 2004, that had declined to 17%."[17]

Given this trend, the time may be coming when all financial institutions compete against each other for deposits. If this battle continues, today's squeeze on net interest margins may become a long-term problem, even when the yield curve widens.

Considering this reality, Credit Union E has to figure not only how to replace aging members once they die, but also how to grow its membership exponentially to compensate for the younger generation's lack of savings.

In fact, some credit unions have determined that it may take 10, or more, members from younger generations to replace the deposits of one member of the older generation. These credit unions are now actively thinking about how to overhaul their operations for this possibility.

The type of deposits credit unions attract is also key.

For the first time, in 2006 CD balances were larger than regular shares

According to NCUA, in 2006 total shares grew at an annualized rate of 4.1%.[18] For the first time, CD balances were larger than regular shares.

Note the components of deposit growth for 2006:

- Regular shares down 6.8%
- Share drafts down 6.8%
- Money markets up (just a little) by 1.4%
- CDs up a whopping 23.8%.

To generate acceptable earnings, credit unions will have to rely more and more on creating non-interest income and on reducing costs through more efficient operations.

Any credit union that understands the demographics and savings patterns of its target market before its competitors will have far better opportunities to adjust its business model in time.

A Changing Talent Pool

Statistics show that there is a potential labor shortage on the horizon.

For example, the 500 largest U.S. companies will lose 50% of their senior managers over the next five years to retirement, according to a recent study by IBM.[19]

What's more, demographic studies show that the younger generation is quicker to change jobs. Consider the following:

- One out of four workers today has been working for less than one year with their current employer.
- The average turnover time for all U.S. employees is three years. Yet for employees 18 to 24 years old, the average turnover time is only 18 months.[20]

Most managers agree that turnover is costly. Each departing employee is likely to create a lengthy cycle of advertising, resume handling, interviewing, reference checking, and training.

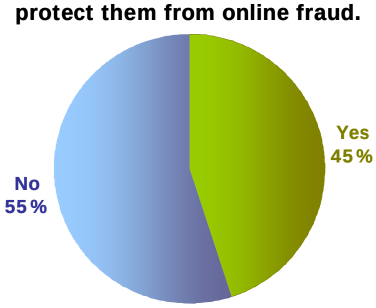
This ongoing difficulty in finding and retaining talent is another factor that credit unions must consider when evaluating their operations, business models, and measures of success.

The Increasing Burden of Compliance

Implementing all the recent changes in regulatory compliance—including the Bank Secrecy Act, the Patriot Act, and Check 21—have proven to be expensive and time-consuming exercises.

When informally surveyed during strategic planning sessions, credit union IT managers said they routinely spend more than 50% of their time on compliance issues.

This time could have otherwise been spent on more productive matters, such as finding ways to streamline processes, create efficiencies, and generate more business.



Source: USA Today, November 1, 2006

Figure 2. Customer Faith in Financial Institutions

As well, security is quickly becoming an issue, as the public's awareness of online fraud is heightened every day. Every credit union must invest resources to build trust with members, and guard against the risk to its reputation that would spike if they became victims of fraud.

Changing times demand changing strategies

As shown in Figure 2, a majority of the population believes that financial institutions are not doing enough to safeguard their depositors. If this trust gap widens, credit unions may have an even harder time attracting and retaining members.

Despite the rush to electronic banking, many people still have serious concerns about its safety. Yet electronic services promise desirable cost savings.

This gives credit unions a difficult tight-rope to walk. On one hand, they must find a way to reassure online depositors that their money is secure. On the other, they must reach out to members who prefer to do in-person banking.

If the balance holds, credit unions could benefit from both more deposits and lower costs. If not, they could be in for the worst of both worlds: slower deposits and higher costs from in-person banking.

The Big Picture Points to the Need to Change

We've seen how in the past 10 years, the competitive landscape for credit unions has completely changed.

Dealing with challenges from all sides, credit unions today face new technologies, demanding consumers, shifting demo-graphics, a depressed saving rate, a fickle talent pool, and increasing regulation.

To survive over the long term, no one can afford to do business as usual. Those who try to rest on their past glories may be in for a rude awakening. Changing times demand changing strategies.

Credit unions desperately need new business models to address this changing landscape. And these new business models can't continue to rely on the same traditional measures of success.

If a credit union continues to use the older measures of success to track its performance, it will very likely miss business opportunities, invite unmanage-able risks, or both.

In any case, applying the traditional measures of success will not provide a sound foundation for a credit union to be highly successful in the long term.

Part 2. Are the Traditional Measures of Success Still Working?

Introduction

Many credit unions target a particular number or short-term ratio to judge their success and compare their performance to their peers. These main targets are listed in Table 2.

Ratios can be important to monitor and assess. But it's more important for credit union managements and boards to agree on **why** each ratio target is desirable, and to understand the potential long-term implications of establishing short-term targets.

Part 2 of this executive briefing examines each of these traditional measures of success, and shows why the traditional way of using it may no longer be relevant in today's redefined banking experience.

Return on Assets (ROA)

Asking "why" it is desirable to target a certain ROA is a key question.

Striving for a certain ROA today, just because it was accomplished in the past, is not a good-enough reason. The full question should be, "Are we risking our safety and soundness, or any potential opportunities, because we don't want to sacrifice current earnings to invest in new business lines or infrastructure?"

Many external forces are causing ROA to decline, even as the industry's assets increase.

Keep in mind that the industry is more than four times the size it was 20 years ago. According to CUNA statistics, the industry average ROA in 1987 was about 0.97%.[21] Yet by the end of 2006, the average ROA was only 0.82%, the lowest level seen in 20 years.[22]

Current earnings are not necessarily a sound measure of long-term success.

In working with hundreds of credit unions, c. myers has demonstrated that accepting lower earnings, with the objective of managing risk, provides more flexibility for dealing with the next change in the economy.

TRADITIONAL MEASURE	TYPICAL TARGET
Return On Assets (ROA)	At least 1%
Current net worth ratio	Increase
High loan-to-share ratio	75%-95%
Asset growth	~10% a year
Membership growth	~5% a year
Employee turnover	Reduce by 50%
Peer comparisons	Stay equal to, or better than peers

Table 2. Traditional Measures of Success for Credit Unions

And all earnings are not created equal. The reason for lower earnings does matter. Targeting lower earnings to manage risk and build opportunities is very different than experiencing lower earnings because of mismanagement, or because unanticipated risks materialized.

Consider the following excerpts from NCUA's Supervisory Letter No. 06-01 on evaluating earnings:

"There is no simple metric for determining what a credit union's retained earnings level should be. A 1% ROA level has served as the 'rule-of-thumb' for good performance for financial institutions for some time.

"The establishment of the CAMEL matrix in 1987 canonized for credit unions a 1% ROA by tying it to a CAMEL 1 component rating for earnings. However, CAMEL ratings are not automatically determined by matrix ratios. Each credit union's earnings level must be evaluated based on the credit union's unique needs, as well as overall economic trends affecting financial institutions."

The letter goes on to say, "The ROA level is not the primary focus of an examiner's assessment of earnings... Lower ROA levels will be viewed positively if they are the result of a sound and well-executed strategy to balance risk exposure, or incur costs to position the credit union to achieve longer-term growth and member service objectives."[23]

A 1% ROA is clearly no longer a sufficient measure of success.

Current Net Worth Ratio

C. myers' in-depth work with over 400 credit unions shows that the current net worth ratio is not an indicator of safety and soundness.

Consider the 15 credit unions represented in Table 3, with current net worth ratios ranging from 7.2% up to 12.8%. To test the net worth strength of each credit union, its risk was simulated using the

CURRENT NET WORTH RATIO	NET WORTH RATIO AT RISK	NET WORTH RATIO NOT AT RISK	POTENTIAL CHANGES IN CUMAA CAPITALIZATION CLASSIFICATION
12.8	1.3	11.5	Well Capitalized
12.2	5.8	6.4	Adequately Capitalized
11.3	11.6	(0.3)	Critically Undercapitalized
10.8	2.6	8.2	Well Capitalized
10.5	4.5	6.0	Adequately Capitalized
10.2	7.2	3.0	Significantly Undercapitalized
9.8	10.6	(0.8)	Critically Undercapitalized
9.4	1.5	7.9	Well Capitalized
9.2	5.6	3.6	Significantly Undercapitalized
8.9	6.4	2.5	Significantly Undercapitalized
8.2	0.0	8.2	Well Capitalized
8.1	9.7	(1.6)	Critically Undercapitalized
7.7	1.4	6.3	Adequately Capitalized
7.4	0.4	7.0	Well Capitalized
7.2	7.0	0.2	Critically Undercapitalized

Table 3. Results of Simulated Interest Rate Changes on 15 Credit Unions

same interest-rate environment, with the results shown in the far-right column.

In the table, the credit unions shown on a white background are considered well or adequately capitalized, while those shown on grey are considered significantly or critically undercapitalized.

Note that the credit union with a current net worth ratio of 11.3% could wipe out more net worth than it has. On the other hand, the credit union with a current net worth ratio of 7.4% is positioned to remain well capitalized under the same simulated conditions.

These statistics clearly indicate that the current net worth ratio is not an indication of safety and soundness for any credit union.

High Loan-To-Share Ratio

Relying on this ratio as an indicator of a successful credit union can be very dangerous and misleading. Here's why.

At the end of 2006, the loan-to-share ratio for the credit union industry was 82%, the highest level in the last 20 years. But remember, at the same time the industry average ROA was 0.82%, about the lowest level during the same period of time.[24]

With an ever-expanding range of financial services to compete with, credit unions have less flexibility to price their offerings. Market forces have begun to reduce the options available to today's credit unions.

Many of the loans being made today are unprofitable, after factoring in the associated fees and the credit risk.

The interest rate and credit risks associated with loan portfolios today are very different from the risks of the 1980s and 1990s.

As well, the delivery channel for loans has changed immensely.

Most auto loans are made through the dealer. Very few credit unions have been able to turn these one-shot loan members into contributing members of their cooperatives.

If these types of loans are not priced appropriately, they can actually drain the credit union's financial performance and derail its strategic objectives. However, this can easily go unnoticed if management is focused simply on achieving a high loan-to-share ratio.

Credit unions that force themselves to achieve a high loan-to-share ratio without analyzing the economic times, and the debt burdens their members are facing, can do long-term damage to themselves.

Different institutions with high loan-to-share ratios can experience anything from strong financial success to dismal failure.

The credit unions that tend to be successful are the ones that look beyond the surface numbers like loan-to-share ratios to focus on the **why's** and **how's** of those numbers, along with the other success factors outlined in this briefing.

Asset Growth and Membership Growth

Credit union executives often hear this:

"We need asset growth."

But the question that's much less often asked is, "Will this asset growth be profitable, sustainable, and good for our membership?"

"We need membership growth."

But what isn't so often asked is, "Will this membership growth contribute value or reduce value for our other members?"

Of course, every credit union needs a certain amount of growth simply to attract deposits, replace lost members, and remain a viable business. But the reasons for growth are often not well-considered.

Growth can be driven by many notions, such as an urge to compete ("We need to be one of the 10 largest in our state.") It can be driven by fear of survival ("If we don't grow we won't survive.") It can even come from a misplaced belief in growth for growth's sake.

Growth is often celebrated and rewarded without considering these questions:

- What kind of member do we want?
- Will the members we attract bring value to the credit union in the short term?
- If not, when will they bring value?
- How long are we willing to subsidize new members until they become contributing members of our cooperative?
- Is this growth sustainable? How long?
- How are we going to get this growth?
- What are the potential consequences (positive and negative) if we achieve our desired growth?

Although there are many different sources of asset and membership growth, two of these are having a noticeable impact on credit unions today: indirect auto lending and certificates of deposit (CDs).

Growth for growth's sake is not a sure measure of success

Membership growth through indirect auto-lending programs is only profitable for credit unions that recognize these customers are one-service members. They must be charged a rate that ensures that they contribute to—instead of reducing—the value of the cooperative.

Many indirect lending programs, while providing growth in loans and membership, are unprofitable after considering dealer fees, loan losses, and the cost of new funds to support the loan growth.

Unprofitable loans to short-term members diminish opportunities for giving value to longer-term members.

There is little chance that the indirect lending delivery channel will go away. In fact, this point-of-sale lending may well become popular for other types of loans, so we could be seeing more of it.

Credit unions that choose to be in this competitive arena must figure out how to use this delivery channel without reducing the value of the cooperative.

Another source of growth in membership and assets is funds raised from rate-chasers. This type of growth can also diminish opportunities for giving back to contributing members.

For example, in December 2006 some institutions were issuing CDs at 6% and loaning out funds at 5.75% (after factoring in dealer fees). This is not sustainable. CFOs must be more vocal to help their marketing and lending managers understand the potential adverse consequences of this strategy.

Before launching a promotion, agree on the amount of funds the credit union is hoping to retain on maturity, and the rate it's hoping to retain them at. The success of the promotion should be evaluated in light of these objectives, not for simply attracting money at the outset.

Growth for growth's sake, without considering the quality or implications of that growth, is not a sure measure of success for any credit union today.

Employee Turnover

It can be a worthy objective to retain employees. Most executives understand the high cost of turnover.

However, it is essential that establishing an ambitious goal, such as reducing turnover by 50%, does not result in keeping people who no longer fit with the organization's objectives because they lack the necessary skill set, buy-in, performance, or attitude.

For example, more and more credit unions have an objective of creating a sales and service culture.

But credit unions that have successfully implemented this new type of culture have also made the necessary tough decisions on staffing.

A certain amount of turnover can actually be a good thing, if the departing employees were not well-suited to the business. Once again, there's more than meets the eye about a traditional metric for success.

Peer Comparisons

True peer comparisons are rare in the credit union industry.

Similar asset size is no indication of a peer. Even credit unions with similar asset sizes in the same geographical location are not necessarily good comparisons. They are likely quite different in their strategic objectives, target markets, board and management philosophies, and membership needs.

After all, if two different credit unions in the same area with the same size aren't different, why are they needed?

It can be good to look at rate offerings of other credit unions, but credit union executives using peer comparisons should make sure they understand what's behind the numbers and ratios they're comparing.

NCUA's 5300 reports do not provide enough detail to really understand the true financial performance of a particular credit union. Determining a credit union's success based on what other credit unions are doing is not a sound practice.

Go ahead, look at the ratios. Ask a lot of questions. But don't measure your own credit union's success based on what anyone else is doing, especially since there is little chance you will ever learn if their strategic objectives are in line with your own.

Return on Equity (ROE)

ROE is not a traditional measure of success in the credit union industry. But since many investment brokers are promoting ROE as a measure of success, this section touches briefly on it.

ROE can be a viable ratio to evaluate for companies with stockholders, such as banks. Generating income and increasing stock value for stockholders are the primary objectives of any for-profit business.

In this case, as the ratio of income generated to dollars invested, ROE is a pure measure of that objective.

But the ownership structure is different in credit unions, and so is the primary objective. Credit unions are member-owned and member-oriented.

Remember the industry adage: "Not for profit, not for charity, but for service."

Bank stockholders can redeem their shares for a profit. But there is no mechanism in place for credit union members to redeem their ownership at will. The owners of the credit union are rewarded, in theory, by better rates, services, and convenience.

Each of these things can potentially reduce net income, so while credit unions

	CURRENT	OPTION 1: LOWER NET WORTH $	OPTION 2: INCREASE EARNINGS	OPTION 3: INCREASE GROWTH	OPTION 4: INCREASE LEVERAGE
Assets	100,000	100,000	100,000	393,600	423,000
Equity	11,000	4,457	11,000	12,357	11,000
Net Income	550	550	1,357	1,525	1,358
ROA	**0.55%**	**0.55%**	**1.36%**	**0.55%**	**0.32%**
ROE	5.00%	12.34%	12.34%	12.34%	12.34%
Net Worth %	11.00%	4.46%	11.00%	3.14%	2.60%

Imagine how much this credit union would have to increase loan rates, lower deposit rates, increase fees, and reduce operating expenses to increase its ROA by nearly 250%?!

LEVERAGE

	BALANCE	YIELD	INTEREST $
Borrow	323,000	5.00%	16,150
Invest	323,000	5.25%	16,958
Net		0.25%	808

Table 4. Alternatives for Increasing ROE

view net income as important, ROE is not the primary decision driver as it is for banks. This ratio does not have the same relevance for credit unions.

A credit union with 11% net worth has two ways to increase its ROE: either increase its net income, or decrease its net worth dollars.

Table 4 shows several examples of the potential structural changes needed to move ROE from an initial value of 5.0% to a target value of 12.34%, which was the average for banks in 2006. As noted above, these measures could work for any for-profit business.

But if the management team and board of any credit union thinks about adopting ROE as a measure of success, they must seriously consider the impact on its strategic direction, safety and soundness, and most of all, ask themselves how increasing ROE will truly benefit members.

The irony is that to improve ROE and supposedly benefit its members, most credit unions need to dramatically increase fees, reduce services, and cut costs, all of which could penalize its members.

The Past May Not Be Appropriate for the Future

While the measures of success outlined in this part may have worked in the past, they are not nearly as appropriate for today and tomorrow.

A more difficult competitive landscape, a redefined banking experience, and the overall economic landscape have made these measures less relevant and less informative to executives.

The convergence of events is forcing the industry to look for other ways to define and measure success.

Part 3 of this executive briefing describes these more helpful measures of success.

Part 3. Success Factors Used By Today's Highly Successful Credit Unions

Introduction

Part 3 of this executive briefing examines the characteristics of highly successful credit unions today, including both qualitative and quantitative measures of success.

c. myers gained this perspective by working with hundreds of credit unions since 1991. These conclusions are based on:

- Analyzing thousands of simulations to help credit union executives better understand their potential financial performance
- Facilitating 100+ strategic sessions since 2005
- Leading 400+ financial decision-making sessions in 2006.

In our view, a highly successful credit union has demonstrated that its target market is consistently choosing to do business with it, and it is consistently generating the earnings needed to support its strategic net worth needs, regardless of external forces.

Target market consistently does business with it: This happens because the credit union is offering a unique value proposition that the target market wants. It takes certain qualitative factors to make this happen, including the ones described in this part.

This does not happen because the credit union has simply achieved a certain ROA or net worth ratio.

For example, Toyota's target market doesn't buy that auto maker's cars because they make more profit than any other auto maker. Rather, they buy the cars for qualitative reasons, because they are reliable, fuel-efficient, have a strong resale value, and so on.

Consistently supports strategic net worth needs: A highly successful credit union can absorb major risks including interest rate, credit, liquidity, and operational risks, all without invading the minimum net worth ratio pre-set by the board and management.

Strategic net worth is quantitative, since a credit union can quantify some of its major risks—interest rate risk, liquidity risk, and credit risk—through simulations.

To some extent, operational risks can also be quantified. But since this is harder to measure, it calls for a qualitative component. Setting a minimum net worth ratio is a judgment call; there is no right or wrong answer.

The minimum typically represents the floor for net worth ratio if a credit union were to experience extremely bad risk conditions, such as interest rate risk and credit risk.

The minimum net worth ratio should be established by considering all the risks that are not completely quantifiable, plus whatever extra margin decision-makers believe they may need to keep the credit union viable while its net worth is rebuilt.

Staying healthy

Without these two factors of success, a credit union can look healthy on the outside, but be dying inside.

In other words, a credit union can be safe and sound regardless of external forces, yet still be dying a slow death because it is not consistently and uniquely meeting the needs of its target market.

Qualitative Success Factors

Through many years of work, c. myers has found that highly successful credit unions use most of the qualitative decision drivers listed in Table 5.

They are not arranged in order of priority, because our research indicates that no one or two decision drivers can create success; it requires a combination of several.

We have articulated this group of decision drivers by drawing on many years of discussions about strategies and business models with the boards and managements of highly successful credit unions.

The following pages discuss each of these qualitative success factors in more detail.

FACTOR	DECISION DRIVER
Purpose	We strive to have every member of the board, management, and staff truly know why our credit union exists.
Leadership	We have the right leaders, supported by the right people, doing the right things, at the right time.
Success	We create our own definition of success; our competitors do not do it for us.
Goals and Strategy	We have clearly defined long-term goals, and all key players know them. We have a clearly defined strategy to reach these goals, and all key players know it.
Target Market	We have a clearly defined target market, and all key players know who that is, and who it is not. We acknowledge that to be competitive, we sometimes have to say "no."
Risk and Results	Our strategy is aligned with our appetite for risk, and this strategy generates our desired financial performance.
Priorities	We are focused on our key priorities, and we execute those priorities well.
Mistakes	We recognize that mistakes are an integral part of doing business. If necessary, we cut our losses in a timely manner.
Thinking	We are strategic and creative thinkers. Relying on conventional wisdom is our last resort.

Table 5. Qualitative Decision Drivers for Highly Successful Credit Unions

Success Factor: Purpose

DECISION DRIVER: We strive to have every member of the board, management, and staff truly know why our credit union exists.

Each credit union needs a unique reason for being. This is the most important decision driver.

This purpose should be clear, concise, understood, and practiced throughout the organization, from the executive level through all the people who have daily contact with members, such as tellers, MSRs, and call center personnel.

It's not good enough for a credit union to say simply, "We are in business to be the primary financial institution for all our members." The board and management need to define what this actually looks like if it is achieved.

As competition increases, the definition of primary financial institution is becoming less and less stringent. Decision-makers have to agree that the credit union's driving purpose is achievable and sustainable.

While this may seem straightforward, consider the following. When asked, "Why do you exist?" most credit union managements and boards could give some sort of answer.

Many had to look up and read their mission statement.

But when asked if the stated reason for existence was used to drive their strategic and tactical decisions, less than 40% confirmed that it was.

And when asked to explain the mission statement so that a teller could understand and describe it to members, there was a lot of head-scratching. In fact, many credit union executives estimate that less than 10% of their employees in regular contact with members truly understand the mission of their institution.

In other words, more often than not, the reason for a credit union's existence was generic, vague, and not understood, and therefore not practiced throughout the organization.

Success Factor: Leadership

DECISION DRIVER: We have the right leaders, supported by the right people, doing the right things, at the right time.

While a strategy may be good, the execution can fall apart if a credit union does not have the right leaders and supporting staff in place to accomplish it.

While every employee can be viewed as a leader in their own right, the key leaders are board and management.

Highly successful credit unions make sure they have the right leaders in place first, and then focus on the supporting staff.

In other words, an effective organization has the right people, focused on doing the right things, at the right time. And they are decisive: They do not waste human capital on small issues, or on revisiting the same issues over and over.

For many credit unions, it can take a long time to get all the appropriate people in place. And it can take tough decisions to reorganize, reallocate, or terminate employees who are not in the right roles.

On the other hand, if a company is constantly reorganizing its staff, this can be a sign of deeper issues, which are typically a result of inappropriate leadership within the board or management.

This decision driver is not easy to achieve; but once achieved, it is exceedingly powerful.

Success Factor: Success

DECISION DRIVER: We create our own definition of success; our competitors do not do it for us.

The managements and boards of highly successful credit unions do not run their operations based on arbitrary "standards" or conventional wisdom.

For example, they do not necessarily believe that any loan is better than an investment, that bigger is always better, that double-digit net worth is an essential goal, or that a 1% ROA is necessary.

Highly successful credit unions define their own success, rather than comparing themselves to the rates and ratios of other institutions. They recognize that most other institutions have different goals, different strategies, different markets, and members with different needs.

Therefore, they realize that making decisions based on fragmentary evidence of what other institutions are doing is dangerous.

This is not to say that successful credit unions do not understand their primary competition; they do. They just do not use what their competition is doing on any particular day as a decision driver for their own strategy.

They set their own course, and chart their own success by their own measures.

Success Factor: Goals and Strategy

DECISION DRIVER: We have clearly defined long-term goals, and all key players know them. We have a clearly defined strategy to reach these goals, and all key players know it.

Several of the previous decision drivers touched on a credit union's goals.

Strategy can be defined as **creating a unique value proposition for a select target market**. This includes doing some things differently than the primary competitors to help stand out from the crowd.

This may seem straightforward, but our research shows that it is not.

When asked if their strategy fit this definition, many credit union executives replied something like this, "We are a credit union in a highly competitive market. There is no way for us to distinguish ourselves. We used to be distinguished based on service, but now everybody is doing that."

Another common response was, "We strive to have the best loan rates, the best deposit rates, and unparalleled service."

Yet for many credit unions, the strategy of offering both the best rates and the best service is not realistic. Promising the best rates could require a major shift to keep operating expenses extremely low, and this could well be in direct conflict with offering the best service.

For many reasons, it is more important for every credit union today to have a clearly defined strategy.

One reason is that the common bond is not so common for most credit unions in today's highly competitive market.

In the past, employers encouraged employees to join and participate in the credit union. That employer/employee relationship does not exist for most credit unions today.

Most credit unions are competing in the open market. This requires some clearly defined strategies and distinctions to make it easier for members and potential members to choose the credit union over another financial institution.

Success Factor: Target Market

DECISION DRIVER: We have a clearly defined target market, and all key players know who that is, and who it is not. We acknowledge that to be competitive, we sometimes have to say "no."

This may be a new exercise for some credit union executives. If so, consider how other successful businesses define their target markets.

For instance, the highly successful grocery store chain Trader Joe's ingrains the following description of their target market in the minds of its team members: "an unemployed college professor who drives a very, very used Volvo."[25]

That's not to say that Trader Joe's wants to attract only unemployed college professors. What the retailer wants to instill in the minds of team members is that they are targeting **intelligent** people (college professor) who care about their **well-being** (Volvo) and are looking for **value** (unemployed).

Credit unions that clearly define their target markets this way are more creative, more effective at serving members, and more efficient at allocating resources.

The reason for this is straightforward: When you have a clear target, you can aim better. Defining a target market makes it far easier for management to evaluate opportunities, priorities, products, services, delivery channels, and the type of human capital needed.

Credit union executives may also go through the process of articulating who is **not** in their target market. This exercise can help avoid strategic conflicts, and allocate resources more effectively.

Success Factor: Risk and Results

DECISION DRIVER: Our strategy is aligned with our appetite for risk, and this strategy generates our desired financial performance.

The managements and boards of highly successful credit unions are focused and financially disciplined. First and foremost, they agree they are running a business, so that over the long term they must be viable in their target market, while continuing to add value to the cooperative.

They also understand that any strategy that looks great on paper, but results in unmanageable risk, is essentially a strategy for failure.

It is vital to project the potential financial results of various strategies in advance. If this shows that some strategy will not generate the desired financial performance, something needs to change. Either the strategy or the desired results must be changed.

Either way, all decision-makers must be on the same page regarding their expectations about risks and results.

> **The fact is, having 15 priorities is the same as having none at all**
>
> — Robert S. Kaplan

Success Factor: Priorities

DECISION DRIVER: We are focused on our key priorities, and we execute those priorities well.

Successful credit unions do not allow their strategic objectives to be diluted by having too many priorities. They constantly prioritize, monitor, measure, adjust, and when necessary, regroup.

This attitude is best summed up by Robert S. Kaplan in his recent article, "What to Ask the Person in the Mirror:"

"The fact is, having 15 priorities is the same as having none at all."[26]

It's rather like trying to run off madly in all directions at once.

You can certainly generate a lot of sound and fury, but in the end, you're not likely to really accomplish much.

Success Factor: Mistakes

DECISION DRIVER: We recognize that mistakes are an integral part of doing business. If necessary, we cut our losses in a timely manner.

Successful credit union managements and boards are confident enough to admit mistakes, work to correct them, and most importantly, learn from them.

Any employee, manager, or board who never makes a mistake is probably not exerting themselves much, or trying out enough new ideas.

Remember: Doing business as usual is no longer good enough.

Success Factor: Thinking

DECISION DRIVER: We are strategic and creative thinkers. Relying on conventional wisdom is our last resort.

We have found that the boards and managements of most highly successful credit unions spend the majority of their time together thinking strategically.

And they think most often about external forces that could create strategic opportunities or roadblocks.

As we saw earlier in this executive briefing, the key external forces that influence the credit union's strategy include economic uncertainties, demographic trends, changes in consumer behavior, significant technological developments, and permanent changes in the competitive landscape.

The strategic thinking process enables successful management teams and boards to evaluate opportunities in light of their strategic objectives, not simply the latest fad, or the fear that "If we don't do it, someone else will."

It also helps recognize, early on, when the changes brought about by external forces are too significant to ignore, and when a credit union must change its tactics, business model, or even strategic direction to deal with these changes.

Quantitative Success Factors

This section describes the quantitative success factors that are common among highly successful credit unions today.

Table 6 lists these factors, along with the associated decision driver for each one.

In our discussions with the boards and managements of successful credit unions, we observed that the why's behind these ratios were more important to them than the ratios themselves. While results, numbers, and ratios can all be quantified, decision-makers need to determine the overall value they are trying to create for their credit unions.

Remember, numbers don't make decisions, people do.

The following pages discuss each of these quantitative success factors in more detail.

FACTOR	DECISION DRIVER
Membership and Asset Growth	We focus on achieving sustainable, profitable growth in members and assets, including assets under management.
Strategic Net Worth	We quantify our strategic net worth needs every step of the way, and we always ensure that we have enough net worth to support our strategic net worth requirements.
Operating Expense to Assets Ratio	We do not embark on any major initiative without quantifying the related costs and risks. We set up exit options and trigger points before implementing any major initiative.
Return On Assets (ROA)	We create sources of sustainable earnings, and we know them inside out.

Table 6. Quantitative Decision Drivers for Highly Successful Credit Unions

Success Factor: Membership and Asset Growth

DECISION DRIVER: We focus on achieving sustainable, profitable growth in members and assets, including assets under management.

This typically starts with the credit union determining its unique strengths and attributes, and how it can use those to grow, while still adding value to the cooperative.

It is essential that the credit union's strengths and unique attributes are aligned with the desires of its target market. The focus is on attracting members who will most likely contribute to the cooperative, not drain it.

For example, attracting new members from promotional CDs without a plan to turn them into contributing members does not fit as sustainable, profitable growth.

For both current and new members, each method of growth includes goals for converting them into contributing members. A conversion plan is developed, implemented, and measured at various intervals.

The reasons for success and failure are evaluated and documented, to be used as learnings for the next initiative.

In this way, seeking growth becomes an exercise, not in chasing short-term numbers, but in building the long-term health of the credit union.

Success Factor: Strategic Net Worth

DECISION DRIVER: We quantify our strategic net worth needs every step of the way, and we always ensure that we have enough net worth to support our strategic net worth requirements.

Successful credit unions analyze their major risks to determine the level of net worth needed to support each risk.

Major risks included credit, interest rate, liquidity, and operational risks. A comprehensive analysis is done for each area. As new business lines are introduced, these too are thoroughly analyzed for potential risks, and these risks are factored into the strategic net worth calculation.

In analyzing risk, managements and boards must stretch their thinking and be brutally honest with respect to how risky a situation could be, instead of viewing it through rose-colored glasses.

This enables them to discuss viable options for offsetting the risk should it become a reality. If the options are unacceptable, the initiative is not pursued.

As noted earlier, our work with hundreds of credit unions with a wide range of net worth ratios has given us solid evidence that the current net worth ratio is not a complete indicator of safety and soundness.

A better indicator is how net worth would hold up from exposure to various risks.

Rather than simply managing to the current net worth ratio, credit union managements and boards can gain much more flexibility if they do the following:

- Agree on their appetite for risks to net worth
- Clearly define their own minimum net worth ratio
- Agree on which risks they are going to prepare for, and which they are going to ignore
- Manage within this framework.

This process helps managements and boards make more efficient decisions regarding net worth. Some have found they were holding more net worth than necessary, while others have found that they need more than they currently have.

Credit unions that follow this process tend to spend more time thinking strategically and proactively. This means they are prepared ahead of time for any potential changes in financial performance over various economic cycles.

Success Factor: Operating Expense to Assets Ratio

DECISION DRIVER: We do not embark on any major initiative without quantifying the related costs and risks. We set up exit options and trigger points before implementing any major initiative.

First and foremost, successful management teams set clear priorities and then allocate resources to support their prime strategies.

Many credit union executives feel that the financial services sector is becoming commoditized. If this is true, then it's essential to focus every available dollar for operations and expansion on the credit union's strategic direction.

The reality is that the cost of operations for many credit unions is not aligned with their strategy. Their operating expenses are ballooning.

What's more, many credit unions are slow to exit initiatives that have failed outright, or are not returning enough value to the cooperative. This causes expenses to balloon even more.

And this lack of focus can cause decision-makers to postpone other strategic initiatives in a misguided effort to support a failed project.

In highly successful credit unions, if an initiative causes operating expenses to grow faster than assets, management and board have already agreed in advance how long they are willing to let this situation occur.

This requires management to segment the expenses directly associated with a specific initiative, such as a branch, to help monitor its progress. Operating expense ratios are then analyzed with and without that specific initiative.

Management always closely monitors the progress of the initiative.

If the initiative is not generating the intended outcome in the agreed time-frame, action plans are drawn up.

The management and board do not assume that the situation will work itself out without intervention.

With this financial discipline in place, no single new initiative can damage the institution beyond its capacity to carry the loss. This gives credit union executives a newfound flexibility.

Success Factor: Return On Assets (ROA)

DECISION DRIVER: We create sources of sustainable earnings, and we know them inside out.

Successful credit unions set ROA objectives in light of what they need to support their strategic objectives and strategic net worth. They do not choose to chase a short-term earnings boost if it doesn't fit within their long-term strategic objectives and appetite for risk.

Therefore, they do not fall into the pattern of expecting each year's ROA to be better than the last.

The focus on analyzing the credit union's sources and sustainability of earnings gives executives an early warning of any possible sustained reduction in performance of the core business lines.

And this buys them the time necessary to think strategically about creating new lines of business.

Conclusions

The world has changed, and will likely continue to change at a faster and faster pace. This means that carrying on business as usual is no longer an option.

Consider this: The social networking service MySpace was founded in July 2003, less than four years ago. Yet by May 1, 2007 it had more than 174 million accounts.[27]

In terms of sheer population, that means MySpace is now the sixth largest country in the world, between Pakistan and Brazil. All this from a social grouping that did not even exist five years ago.

Facing Many Challenges

For credit unions, the changing business landscape means facing many challenges from new technology, the consumers' demands for convenience, shifting demographics and a lower saving rate, an ongoing struggle to find and retain suitable employees, and an increasing burden of regulation.

None of these trends seem likely to diminish in the near future; if anything, they will all get more severe.

As well, fresh new changes to our economic and cultural environment will surely continue to present themselves.

No one can predict exactly how these changes will take shape.

But one thing is clear: For any credit union to survive and thrive in the future, it will need different, perhaps broader thinking in two key areas.

Key Recommendations

First, every credit union must re-evaluate its current business model, and update as necessary.

Second, every credit union must re-consider how it measures success.

This is the only way to avoid measuring the wrong things, perhaps even measuring things that are actually in direct conflict with the organization's new strategic objectives.

We have seen how several supposedly strong financial institutions fell apart in a few short years, once they got out of touch with the realities of doing business in the 21st century.

To avoid the same fate, today's credit unions must hear the message and adapt to the changing times.

Strategic Visioning

The appendix outlines an established process that many credit unions have found valuable.

The outcome of this exercise will be a credit union better equipped to deal with today's competitive challenges, and better focused on measuring the most appropriate success factors for its operations.

About the Authors

C. myers is led by a team of five principals, each of whom contributed to this executive briefing.

Sally Myers, CEO, and **John Myers, President**, each have over 22 years of experience in the financial services industry. For the past several years, their focus has been on credit union business strategy and balance sheet management.

A dynamic team of sister and brother, Sally and John have each worked closely with hundreds of credit union boards, senior managements, and their regulators—having developed a reputation as innovators of sound and pragmatic business and risk management practices.

Their proven depth of industry knowledge aids credit union boards and CEOs in asking the right questions while deciding strategy. In 2007, each will facilitate dozens of strategic planning sessions and key strategic meetings.

Rob Johnson, EVP/Principal, joined c. myers in 1992. He has years of experience working with credit union boards and managements, including many of those with over $1 billion in assets. He is regularly a featured speaker at industry conferences and meetings with national and state regulators. Operationally, he guides our development team which is responsible for creating and maintaining all c. myers' software applications such as those used for risk, budgeting and liquidity management.

Pete Crusius, SVP/Principal, has over 23 years of experience in the balance sheet and risk management field. He works with credit union boards and managements of all sizes, helping them to better understand their risks from the decisions they've made, as well as the potential implications of decisions under consideration. He is also a featured speaker for industry trade groups. Operationally, Pete serves as c. myers' CFO.

Adam Johnson, SVP/Principal, joined c. myers in 1994. Since that time he has worked with hundreds of credit union boards and managements. In addition to facilitating dozens of strategic planning sessions, he also facilitates c. myers' Financial Solutions Sessions, which focus on identifying realistic solutions for credit unions that are not satisfied with their financial performance. Operationally, he manages our dynamic and growing client services team.

About c. myers

Since the 1980s, c. myers' principals have been providing intellectual leadership in business strategy development and balance sheet risk management to CEOs, senior managements, and boards.

Since 1991, c. myers has focused on credit unions. As a result, hundreds of credit unions, including half of those over $1 billion in assets and about 25% of those over $100 million, have used it's risk management tools or services.

Also, numerous credit unions have come to rely on c. myers' unique and effective process for facilitating strategic planning sessions.

C. myers' work and research covers the entire decision-making process, from strategic visioning and long-term risk quantification, to business planning and short-term budgeting.

In c. myers' view, a highly successful credit union has two key factors in its favor:

- A target market that consistently wants to do business with it
- A sufficient flow of earnings to support its strategic net worth requirements, regardless of external forces.

We hope that this executive briefing helps your credit union achieve both.

Appendix: A Strategic Visioning Process for Credit Unions

This appendix describes a robust and time-tested strategic visioning process for credit unions, as shown in Figure 3.

In a nutshell, strategic visioning is about deciding where participants want the credit union to be at a given point in the future. Arriving at that desired future requires participants to answer the following very big questions:

- **Strategic Discovery**: *Where are we today?*
- **Strategic Thinking:** *What could our world look like tomorrow?*
- **Strategic Planning:** *Where do we want to go?*
- **Strategic Implementation:** *How are we going to get there?*

Throughout this process, it is important to keep in mind that a strategy is not the final answer. Strategy is the result of your best thinking, given the quality of the questions you ask.

Thinking strategically requires at least two things of participants: to ask and address thought-provoking questions, and to remain flexible in their thinking.

This is not always easy, and the conclusions are not always pleasant. To optimize thinking, it is important to ask the right questions.

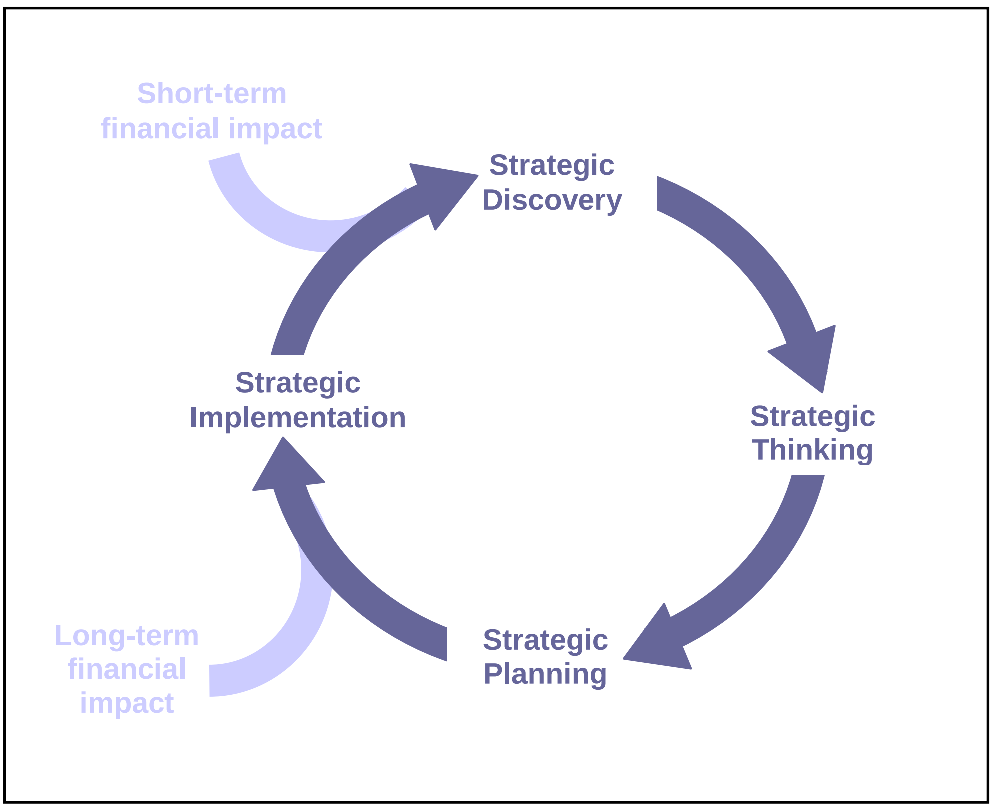


Figure 3. A Strategic Visioning Process for Credit Unions

But unfortunately, thought-provoking questions don't often come with easy answers. And easily answered questions can be misleading and dangerous.

Surrounding yourself with people who think differently may seem inconvenient in the short term, but listening to them can help your thinking for the long term.

Strategic Discovery

This process explores changes in external forces that the credit union has no control over but must still respond to, such as:

- Economic trends, including changes in interest rates
- Demographic and behavioral shifts
- Changes in competitive landscape
- Technology
- Political and regulatory trends
- Membership trends

During this process discussions take place regarding how these trends/shifts can affect the credit union's strategic decision-making process.

To facilitate decision making, it is beneficial for participants to openly discuss current trends and uncertainties.

The world around the credit union includes many uncertainties. No one knows how the next chapter will unfold.

Regularly investing time to identify and discuss what the credit union's board and management team would do if various scenarios played out is an excellent exercise to put into practice.

Doing so puts any credit union one very big step ahead of competition should a given scenario suddenly become reality. Examples of such uncertainties include:

- What will happen to interest rates?
- If they go up, will there still be demand for loans?
- What might happen if real estate values drop?
- What options will Baby Boomers have in retirement?
- How will the credit union stay competitive and grow membership and assets?

Strategic Thinking

This process helps management and board rehearse tomorrow today, so that decisions can be made swiftly with confidence when the future suddenly arrives.

For example, what could the future look like if our members begin to view the Internet as their primary financial institution? What if we have a major security breach?

Strategic Planning

This process is used to decide the long-term strategy and direction of the credit union. This answers the question: Where do we want to take the credit union?

Strategy is the creation of a **unique and valuable proposition for a select target market**. A strategy must include doing some things differently than the credit union's primary competitors.

Strategic Implementation

This process helps the management and board decide how the credit union is going to get where it wants to go, and answers questions such as these:

- *Who is going to do what and by when?*
- *Do we have the right who to do the what?*
- *What internal changes do we need to make?*

Strategic implementation also includes monitoring and adjusting as necessary.

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