

Alloya Corporate FCU

Anatomy of a Merger

The Credit Union Guide to Ensuring a Successful Merger

By, John Collins, Senior Vice President, Strategy and Risk Management

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Merger

The word elicits strong emotions throughout the financial services industry, including credit unions. For some, it is viewed as an exciting opportunity to grow. For others, it is dreaded and feared as a loss of control and quality. Like many things, which camp you may fall in depends on your point view. The objective evidence makes a clear and compelling case that mergers are here to stay as financial institutions of all types continue to consolidate. While academicians have long debated whether economies of scale and scope exist in financial institutions, market participants have spoken via their actions. One only needs to look to the three largest U.S. banks for evidence, as each is larger than the asset base of the entire credit union industry. So if mergers are here to stay, how should credit unions respond? Is a merger a good strategy for members? The answer is that it may be, if the merger partner is selected for the right reasons and it is planned and executed thoughtfully and carefully.

Value

We all work for our members, so a merger should create value for our memberships. In a merger, value should be created for the membership of both credit unions. Generally value will be created in the following areas in order of importance:

- *Financial* – Mergers create value by aggregating scale to reduce operating expenses or increase revenues. Redundant expenses can be eliminated, typically in the back office, or new revenues generated through new product offerings to new and existing members.
- *Strategic* – Value can be created through economies of scale and scope that allow for new products, new delivery systems, improved service or access to products unavailable to smaller individual institutions.
- *Risk* – Expanding the geographic footprint and/or the organizational scale can reduce concentration risk. Additionally, spreading existing risks over a larger capital base reduces enterprise-wide and systemic risk.

Merger Partner

Okay, so we think merger might be a good strategy for us, how do we go about finding the right dance partner? There are a number of ways to approach this. First and foremost among them is finding a willing partner. The best way to identify potential partners is to ask if mergers are part of their strategy. Mergers are large, complex and transformative transactions at any level. If the Board and Senior Management of a prospective partner have not discussed merger as a possibility and thought about the strategic implications, the credit union is probably not a willing or ready candidate.

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Getting Started

We think a merger would be valuable for our members and we found a couple of possible candidates, so how do we get started? Alloya has found across its ten mergers a process that engages management and the Board in a progressive manner that evaluates the potential value proposition. The general process is:

- *CEOs Meeting* – The CEOs should meet in-person as both need to be engaged in the process. The meeting will seek to identify the potential value that could be created through a merger, and explore the key merger terms and determine if there are any “deal breakers” (see below). If a reasonable level of agreement can be achieved, the next step would be for the Board Chairs to meet in person.
- *Board Chairs Meeting* – The Board Chairs meet next and discuss the same topics as the CEOs and any other relevant topics. If a reasonable level of agreement can be achieved, the next step is for the Board Executive Committees to meet in person.
- *Executive Committees Meeting* – The Board Executive Committees should meet next and discuss the value proposition and a Letter of Intent (LOI) to merge. The hoped for outcome would be agreement on the key LOI terms.
- *Full Board Meeting* – Both Boards meet in person. The meeting serves two purposes. First, the Boards would hope to execute an LOI to merge. Second, this presents an opportunity for the Boards to begin to develop a working rapport.

Deal Breakers

Ok, so what’s a “deal breaker?” In mergers, there tend to be several key terms that, once agreed upon, set the framework for the rest of the transaction and are the foundation of the LOI. If most of these items cannot be agreed upon by both parties, they typically break the deal. The following is a list that has been compiled based on previous Alloya LOIs. Not all terms apply to all mergers, but this provides a reasonably comprehensive list of key items.

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Letter of Intent Term	Current Credit Union A	Current Credit Union B	Future Credit Union
Surviving Charter			
Which members vote			
Headquarters location			
Chief Executive Officer			
CEO Location			
Board Chair			
Board Vice Chair			
Board Treasurer			
Board Secretary			
Board Majority			
New Board Seats – Number			
Committees – Number to add/subtract			
Office Locations			
Corporate Name			
Bylaws			
Policies			
Capital program			
Pricing			
Account Structure			

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Execution

Ok, so we want to merge, we have a partner and we have deal framework (LOI). How do we get it done? Mergers have four phases that vary in length based on complexity, and the good news is that you have already completed most of the first phase.

- *Negotiation* – The first phase is to identify a willing partner and agree on the key merger terms as noted above.
- *Planning and Due Diligence* – Once the LOI is signed, both parties will need to perform due diligence to understand the financial and operational state at the partner. Due diligence can be performed by staff or outsourced. The other key step at this point is to begin the planning process. Mergers are every bit as complicated as core system conversions and extensive planning needs to occur to prevent adverse member impact.
- *Documentation and Approval* – Mergers need to be approved by regulator(s) and may require lengthy and specific documentation. You will also need to collect the documentation from the planning process above to communicate to staff in the execution phase.
- *Execution* – Once regulatory approval is received, the plans developed must be implemented. This includes a broad range of activities usually impacting the entire organization over at least a couple of months and possibly longer.

Pitfalls

What are the major risks to a merger and how do we avoid them? The bad news is there are a number of pitfalls; however, the good news is that with proper advance communication and planning most can be avoided or mitigated. The following are some of the major pitfalls and suggested remediation:

- *Strategic Alignment* – If the two organizations merging are not aligned strategically, this can cause significant issues. Often this materializes in the form of ineffective executive decision-making and conflicting management styles, both of which impair effective operations and quality member service delivery.
 - Remediation – This issue can be addressed by ensuring the CEOs and BODs discuss the issue during the Negotiation phase. One way to look at this issue is to use a tool that describes business models as excelling at Products, Service or Operational Efficiency. While all three are usually present, one dominates. Agreeing which of these will be primary going forward can go a long way to addressing this issue.

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- *Poor planning and execution* – If the merger is not effectively planned and the plans not effectively managed, the merger may not achieve its desired ends. You can undo all the value creation a merger should unlock with poor planning and execution.
 - Remediation – For larger mergers, consider using a Project Management Office (PMO) with dedicated project management staff to ensure that all tasks and follow-up are completed timely. The PMO will report to an executive sponsor team with staff from both credit unions. The executive sponsor team should be established to make the key decisions that will inevitably surface, and also to address any individual plans that fall behind. This is where it gets sticky as mergers almost always result in less staff (see below). The focus should be on the members. First, decide which products are superior and will be used going forward. This will dictate which systems will survive to provide those products. The staff most familiar and efficient at operating those systems and/or proving those services should be retained.
- *Key Staff Risk* – Key staff, needed to execute the merger, that leave prior to or in the midst of the execution phase can create significant problems. This can be devastating to operations, hurt service levels and demoralize staff. The reality of most mergers is that some staff will be severed. It is very unlikely that a merger can create economic value for its members without this occurring.
 - Remediation – People want to know early how and if they are impacted. The best approach is to set the Executive Team early (typically during the Negotiation Phase). The Executive Team, with the help of the PMO, decides early in the planning process the staff that will be impacted. Once decided, staff should be told their likely future as soon as the decisions are final. *If you were one on those staff, wouldn't you want to know as soon as possible?* Consider the use of severance plans and retention bonuses for key staff who are needed during the transition and will be displaced after the merger. Treating staff fairly and with compassion is the right thing to do in a people industry like credit unions and prevents future litigation by angry former staff.
- *Culture* – This is almost always the most difficult part of a merger. Organizations develop styles, skills, processes and ways of doing things over years that become ingrained. Along comes a merger and for almost everyone these change. While it is difficult to directly measure the impact of poor cultural convergence, its effect will be directly felt by members and show up in the new credit union's lower growth rate and/or profitably, as it struggles to operate effectively.

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- Remediation – Cultural convergence takes time. Culture is people and people need time to adapt to change, so everyone needs to be patient with each other. The three best ways to create convergence: communicate, communicate and communicate. Creating venues for face-to-face communication is critical. The Boards should meet in a joint session prior to execution of the LOI. Executive staff should meet during the first two phases to get to know each other. Management teams should meet to discuss plans under development. Joint problem solving allows each team to recognize the value that their counterparts bring and recognize that they may serve their members differently, but both share a passion for serving their members.

Conclusion

Mergers can unlock tremendous value for members, increasing organizational scale, scope and capabilities. However, a poorly planned, executed or communicated merger can quickly erode the value it was intended to create. Carefully selecting a merger partner, understanding the value proposition of the merger; then effectively planning, communicating and executing the merger can ensure members receive the additional value envisioned.

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About the Author



John Ingersoll Collins, Senior Vice President, Strategy and Risk Management

As Alloya's Senior Vice President, Strategy and Risk Management, John Ingersoll Collins is responsible for the development and implementation of the strategic planning process. Collins also supports the project management function as it coordinates the implementation of strategic initiatives, such as merger transactions and large scale member conversion projects. Further, he is responsible for the Risk Management area that measures, reports and monitors risk associated with interest rates, credit and operations. He also assists the CEO in the general management and administration of the corporate by providing support and counsel in strategic and industry issues. This includes corporate governance coordination, corporate charter, the coordination of corporate general counsel activities, policy and bylaw administration and compliance, and management of the corporates' goals and objectives.

He began his credit union career almost 30 years ago and joined the corporate in 2001. Prior to that, Collins worked as CFO for Great Lakes Credit Union in North Chicago, IL for ten years. His background also includes holding several positions at First Community Credit Union in Houston, Texas, where he started his career as a teller, climbing to the position of Vice President.

Collins served formerly as chair of Mid-States Corporates' Credit Committee and Asset/Liability Committee (ALCO), and has the unique distinction of having been both a corporate member and a volunteer official before becoming an employee. He served as Treasurer of Illinois CUES and has held all other offices, including President. Collins also served as the Treasurer of the Fox Valley Montessori School Board of Trustees and as the lead independent Director of CTI Industries (CTIB), a NASDAQ traded firm.

Collins holds his Bachelor's in Economics, History and English from Ripon College in Ripon, WI. He also holds his M.B.A. in Finance and Management from Emory University in Atlanta, GA. He has also attended post graduate education at the Kellogg School of Management in Evanston, IL, including the KMI program, and at Duke University's Fuqua School of Business.