# A CRITICAL ANALYSIS OF A CREDIT UNION'S STRATEGIC PLAN

by

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# Abstract

Coast Capital Savings (CCS) is the second largest credit union in Canada with 360,000 members and $8.9 billion. CCS has a 10-year strategic plan to grow to one million members, $20 billion in assets, and to have operations in all ten provinces in Canada by the year 2012. CCS plans to achieve this growth in two ways: 1) organically, with innovative products and services, and 2) through mergers and acquisitions.

This paper analyzes the five-year progress of the strategic plan, since 2002, and offers strategic alternatives and recommendations based on research and trends in the credit union and banking industry. The analysis of the financial services industry in Canada identifies key success factors that can be used by CCS to achieve a competitive advantage against its competitors in British Columbia. The paper focuses on four of CCS' major credit union competitors, Vancity, Envision, Prospera, and Westminster, and one bank, Royal Bank of Canada.

The paper proposes two strategic alternatives: mergers and acquisitions, and enhanced technology. As part of the internal analysis of the organization, the second alternative was modified to propose a strategic alliance with CommunityLend, a peer-to-peer, Internet lending company. The paper recommends that CCS find a suitable merger partner and initiate the alliance with CommunityLend.

# Dedication

To Meredith, whose genius does not require an MBA and who gave me the time and space to complete this degree.

# Acknowledgements

I would like to thank the members of XEMBA, the eXtreme EMBA team, for their friendship and support while pursuing this degree: Bonnie Whelan, Kianoosh Akhavein, Bobby Keomany, and Dan Stevens.

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# List of Acronyms

| | |
|---|---|
| **ABM** | Automatic bank machine |
| **BAI** | Bank Administration Institute |
| **BC** | British Columbia |
| **BMO** | Bank of Montreal |
| **CBA** | Canadian Bankers Association |
| **CCS** | Coast Capital Savings Credit Union |
| **CDIC** | Canadian Deposit Insurance Corporation |
| **CEO** | Chief executive officer |
| **CIBC** | Canadian Imperial Bank of Commerce |
| **CSR** | Customer service representative |
| **CRM** | Customer relationship management |
| **CUCBC** | Credit Union Central of British Columbia |
| **CUCC** | Credit Union Central of Canada |
| **CUCO** | Credit Union Central of Ontario |
| **CUDIC** | Credit Union Deposit Insurance Corporation |
| **CUNA** | Credit Union National Association |
| **DNM** | Distributed network model |
| **ECU** | Envision Credit Union |
| **FICOM** | Financial Institutions Commission of BC |
| **FSP** | Financial service provider |
| **FSR** | Financial service representative |
| **ICT** | Information and communication technology |

| | |
|---|---|
| **IT** | Information technology |
| **ITG** | Information Technology Group |
| **KSF** | Key success factor |
| **LOC** | Line of credit |
| **MBA** | Master of Business Administration |
| **NAFCU** | National Association of Federal Credit Unions |
| **NBC** | National Bank of Canada |
| **NII** | Net interest income |
| **NSF** | Non-sufficient funds |
| **OE** | Operating efficiency |
| **P2P** | Peer-to-peer |
| **PCU** | Prospera Credit Union |
| **PPE** | Property, plant and equipment |
| **RBC** | Royal Bank of Canada |
| **ROA** | Return on assets |
| **ROE** | Return on equity |
| **ROI** | Return on investment |
| **SET** | Senior Executive Team |
| **TD** | Toronto Dominion bank |

# Glossary

| | |
|---|---|
| **Caisse populaires** | The French term for a credit union. Primarily used in Quebec. |
| **Contact Centre** | CCS' telephone call centre in Surrey, BC. |
| **Deposit-taking institution** | A bank, trust company, credit union, caisse populaires or other financial institution that accepts deposits from the public and provides regular banking services such as chequing and savings accounts.[1] |
| **Member** | A customer of credit union who meets the minimum deposit requirements of the institution. |
| **Vancity** | Vancouver City Savings Credit Union |
| **Westminster** | Westminster Savings Credit Union |

[1] Department of Finance Canada. (2006). Retrieved April 18, 2007, from http://www.fin.gc.ca/gloss/gloss-d_e.html#dep_taking_instit

# 1 Introduction: Banks, Credit Unions and Strategy

The purpose of this paper is to analyze the 10-year strategic plan of Coast Capital Savings (CCS) and the progress they have made in achieving the targets of their plan in the past five years. The paper will offer strategic alternatives CCS can pursue to remedy shortfalls in their plan and to enhance their competitive advantage. A comparative, competitive analysis of CCS against the five largest credit unions in British Columbia (BC) and one bank is conducted to arrive at the key success factors (KSFs) in the retail banking[2] industry in the province. The paper will also discuss new, Internet-based technologies influencing financial institutions.

The scope of this paper is limited to the retail banking operations of credit unions and banks. Many credit unions and banks have subsidiary corporations that offer insurance products, mutual funds, equipment leasing, and venture capital. The products and services of subsidiary corporations are not analyzed in this paper.

CCS is the second largest credit union in Canada with 360,000 members (customers) and $8.9 billion[3] in assets at the end of 2006. It provides retail banking products and services to people in the greater Vancouver area and Vancouver Island. CCS employs 2,000 people at 49 branches and their administrative offices. The branches are located in the greater Vancouver area (34) and Vancouver Island (15). It also provides services to its members through 74 automatic bank machines (ABMs), online banking, and a telephone contact centre.

[2] Retail banking is a generic term used to describe the structure and activities of deposit-taking institutions including banks, credit unions and caisse populaires, and trust and loan companies
[3] Unless otherwise noted, all financial data is specified in Canadian dollars.

CCS is one over 2,500 companies offering financial services in Canada.[4] CCS' competitors include banks, other credit unions, trust companies, and a wide variety of specialty financial providers, such as mutual fund and insurance companies. CCS' primary competitors in British Columbia (BC) include the province's five largest credit unions and many of the country's domestic and foreign banks, including the largest, Royal Bank of Canada. The five largest provincial credit unions are Vancity, CCS, Envision, Prospera, and Westminster Savings.

CCS' 10-year strategic plan is to grow to one million members, $20 billion in assets, and to have operations in all ten provinces in Canada by the year 2012. CCS plans to achieve this growth in two ways: 1) organically, with innovative products and services, and 2) through mergers and acquisitions.

By 2006, CCS had achieved assets of $8.9 billion and a membership of 360,000. This was an increase of $2.8 billion (45%) in assets and 60,000 (20%) members through organic growth in the five-year period since 2002. CCS has five years to approximately double their assets and triple their membership to achieve the targets stated in their plan.

## 1.1 Objective of this paper

The objective of this paper is to analyze the CCS' strategic plan and offer strategic alternatives that CCS can implement to achieve the goals in their plan. The paper contains an external analysis of the financial services sector in Canada and identifies the key success factors (KSFs) in the industry. The internal capabilities of CCS are compared against the strategic alternatives and recommendations are presented.

[4] Department of Finance Canada. Retrieved July 5, 2007, from http://www.fin.gc.ca/toce/2005/fact-cfsse.html.

## 1.2 Structure of this paper

This paper consists of four chapters. The first chapter is an overview of the financial services sector in Canada and BC. The second chapter is an external analysis of the sector that utilizes Porter's Five Forces model to identify the KSFs for the industry. The second chapter also includes a competitive analysis of the five largest credit unions in BC and presents strategic alternatives. The third chapter is an internal analysis of CCS that includes management preferences, the organizational structure, and resources. The final chapter offers recommendations to CCS in pursuit of their 10-year strategic plan.

## 1.3 The financial services sector in Canada

The financial services sector in Canada is composed of banks, credit unions and caisse populaires, trust companies, insurance companies, mutual fund companies, securities dealers, and finance and leasing companies. It also includes independent financial advisors, insurance agents and brokers, and pension fund managers. Credit unions are part of the deposit-taking sector of the industry that consists of banks, both domestic and foreign, credit unions, and trust and loan companies. Insurance companies, mutual fund companies, credit card companies, and the like, are not considered deposit-taking institutions because they do not accept deposits from the public and do not offer regular banking services, such as chequing and savings accounts.

The financial services sector is highly competitive due to changes in federal laws and regulations, and innovations in technology. Changes to the regulatory framework have increased the presence of foreign banks in the Canadian market and technological developments have triggered the emergence of monoline credit card issuers, like Capital One Bank, and peer-to-peer (P2P) lending and Internet-only banking companies, such as Zopa and ING Direct, respectively. There are also unregulated service providers in the lending arena that include credit card

companies and vehicle financing companies, such as GMAC (General Motors Acceptance Corporation).

This section examines the financial and structural positions of banks and credit unions as part of the deposit-taking sector of the financial services industry. Although credit unions compete against other credit unions, and banks compete against other banks, institutions like CCS feel their primary competitors are banks. It is important to understand the comparative differences between banks and credit unions because it shapes the strategies of organizations like CCS. Trust companies and non-deposit taking institutions are beyond the scope of this paper.

Table 1-1 contains a summary of the types and numbers of financial institutions operating in Canada according to the Canadian Bankers Association's (CBA) statistics of 2005.

**Table 1-1: Financial Services Sector, 2005**

| Type of institution | Number of active firms[5] |
|---|---|
| Large domestic banks[6] | 6 |
| Small domestic banks | 13 |
| Foreign-owned bank subsidiaries | 49 |
| *Credit unions*[7] | *1,156* |
| Trust companies | 29 |

[5] These numbers vary from those published by Department of Finance Canada in 2003. See http://www.fin.gc.ca/toce/2005/fact-cfsse.html, as of May 1, 2007.
[6] Royal Bank of Canada, Toronto Dominion, Canadian Imperial Bank of Commerce, Bank of Nova Scotia, Bank of Montreal and National Bank of Commerce.
[7] Leshchyshen (2006, p. 24).

| Type of institution | Number of active firms |
|---|---|
| Life insurance companies | 89 |
| Investment dealers | 180 |
| Mutual fund companies | 61 |
| Pension fund managers | 58 |
| Independent financial, deposit and mortgage brokers | 4,000+ |

See Appendix 2, Size of Financial Institutions in Canada, for a comparison of assets of the top ten financial service institutions in Canada.

### 1.3.1 Structural differences between banks and credit unions

The regulatory structure of the Canadian financial services sector plays an important role in the formation of strategy for banks and credit unions. Banks are governed federally under the Bank Act of Canada and they can operate in all ten provinces, and internationally. Banks are members of the Canadian Deposit Insurance Corporation (CDIC). For banks, deposit insurance limits were increased to $100,000 as per Bill C-48, approved in June 2005.[8]

Credit unions and caisse populaires are provincially incorporated and regulated, and they cannot operate outside provincial boundaries. Most credit unions and caisse populaires belong to national and provincial trade associations called "centrals." Centrals provide liquidity management, wholesale lending, cheque settlement and electronic services to member credit unions. Although credit unions are governed provincially, centrals are governed through federal legislation under the Cooperative Credit Associations Act.

[8] Fiscal Agents Financial Services Group. Retrieved July 7, 2007, from http://www.fiscalagents.com/newsitems/cdic.shtml.

Credit unions in BC belong to Credit Union Central of British Columbia or CUCBC. Credit unions in BC are regulated under the Financial Institutions Act of British Columbia and the Credit Union Insurance Act of British Columbia.[9]

Credit unions must be members of the Credit Union Deposit Insurance Corporation of their home province. Unlike banks, credit union deposit insurance coverage varies by province. (See Appendix 8 – Summary of Canadian Deposit Insurance Limits). The fragmented nature of the regulatory structure for credit unions is cumbersome and subject to provincial variability, as indicated by the disparity in deposit insurance coverage.

Credit Unions are co-operative, non-profit financial institutions owned and controlled by their members. Customers are required to become credit union members; each member is entitled to one vote regardless of the size of their deposits or share capital held. A credit union's main objective is to serve the financial needs of its members including the provision of mortgages and consumer financing. (See Appendix 7 - Cooperative Principles of Credit Unions). Banks, however, are for-profit institutions, structured to increase shareholder value in the form of stock dividends.

In the financial services sector, size matters. The five largest financial institutions in Canada are banks, which is not surprising given their ability to operate across Canada and internationally. Credit unions are much smaller due to the limitation of provincial operation; however, they too have grown in size through mergers and acquisitions. Costs are lower for larger credit unions; therefore, they can afford to offer better services to members, more variety of products, higher interest rates on deposits, and lower interest rates on loans (Wilcox, 2005).

[9] Department of Finance Canada. *1997 Review of Financial Sector Legislation: Proposals for Changes.* Retrieved July 7, 2007 from http://www.fin.gc.ca/FSL97/easing.

Banks possess additional competitive advantages over credit unions, beyond national and international operational capabilities. They are able to raise capital on global markets and are able to operate internationally. In fact, between 1997 and 2004, the total real value of services (net interest income plus non-interest income, in 1997 dollars) produced by domestic banks rose at an annual rate of 1.8 percent in Canada whereas the worldwide gain was much higher at 4.8 percent. Credit unions, on the other hand, raise capital by increasing membership.

### 1.3.2 Financial differences between banks and credit unions

Banks are the largest institutions in the Canadian financial services sector. Banks maintained approximately 55 percent of the assets in the financial sector. The combined assets of banks were reported at $1,858 billion in 2005. The six largest banks held 76 percent of the assets of deposit-taking institutions in Canada.[10]

By comparison, credit unions hold approximately seven percent of assets among deposit-taking institutions. For credit unions in Canada, the combined assets were $179 billion on a membership base of 10.7 million in 2005.[11] The largest 102 credit unions represented 40 percent of the total assets of the 1,156 Canadian credit unions. (See Appendix 5 – Top 10 Credit Unions in Canada by Assets Size).

Table 1-2 contains a 2005 comparison of the 102 largest credit unions to the country's nine chartered banks. Chartered banks outgrew the largest group of credit unions. Lower return on assets among credit unions was largely due to lower operating efficiencies.

[10] Department of Finance Canada. Retrieved July 7, 2007, from http://www.fin.gc.ca/toce/2005/fact-cfsse.html

[11] Credit Union Central of British Columbia (CUCBC). Retrieved July 7, 2007, from http://www.cucbc.com/aboutus/faqs.html.

**Table 1-2: Financial institutions - asset comparison**

| Sector | Assets ($mils) | Asset Growth % | Return on equity % | Return on assets % | Capital ($mils) | Capital % assets |
|---|---|---|---|---|---|---|
| Credit unions (102)[12] | 72,472 | 10.5% | 11.4% | 0.65% | 4,427 | 6.31% |
| Chartered banks (9)[13] | 1,857,599 | 11.1% | 14.7% | 0.69% | 84,458 | 4.55% |

*Source: Adopted from Leshchyshen (2006), p. 24.*

Credit unions rely exclusively on net interest income as their primary source of revenue, although some credit unions have been increasing fees to compensate for lower net interest margins. Banks generate significant fees from their brokerage, mutual fund, and other investment services. Table 1-3 compares 2005 net income results for the credit unions and banks.

**Table 1-3: Financial institutions - net income comparison**

| Sector | Net income ($mils) | Dividends ($mils) | Payout ratio % |
|---|---|---|---|
| Credit unions | 447 | 124 | 28% |
| Chartered banks | 12,260 | 6,331 | 52% |

*Source: Adopted from Leshchyshen (2006), p. 25.*

Payout ratios for credit unions represent dividends paid to members in the form of dividends to members or lower lending rates. Dividends in chartered banks are paid to stockholders and not directly to bank customers.

The 102 largest credit unions have a higher cost structure than other financial institutions. This is partly due to the ability of chartered banks to generate other income from investment services business, trading in foreign currencies, and commercial operations. A higher net interest

[12] See Leshchyshen (2005, p. 34) for a list of Canada's 102 largest credit unions.
[13] RBC, TD, Bank of Nova Scotia, BMO, CIBC, NBC, Laurentain Bank, Canadian Western Bank, and Pacific & Western Bank.

margin is indicative of credit unions' abilities to offer more favourable interest rates and manage their spreads. Table 1-4 shows operating results as a percent of average assets.

**Table 1-4: Financial institutions - operating results comparison**

| Sector | Net interest margin % | Other income % | Operating income % | Operating expense % |
|---|---|---|---|---|
| Credit unions | 2.76% | 0.99% | 3.76% | 2.87% |
| Chartered banks | 1.72% | 2.15% | 3.87% | 2.78% |

*Source: Adopted from Leshchyshen (2006), p. 26.*

### 1.3.3 Credit unions in British Columbia

There are currently 51 credit unions in BC serving approximately 1.5 million members. At the end of 2005, BC credit unions held $36 billion in assets, with the two largest credit unions, Vancity and CCS, holding $18 billion or 51 percent of credit union assets in the province. The other three largest credit unions in the Vancouver area are Envision, Prospera, and Westminster Savings. (See Appendix 10 – Top 10 British Columbia Credit Unions 2005). A comparative financial analysis of these credit unions against CCS can be found in Section 2.9 of this paper.

### 1.3.4 Credit union consolidation

The number of credit unions has declined by over 50 percent since 1995 at which time there were 2,448 credit unions in Canada. By the end of 2005, there were 1,156. Double-digit declines were experienced in the years 2000, 2001 and 2002; there was an eight percent decline in 2003 and 2004. There was a loss of 42 credit unions in 2005 or a decline of six percent (Leshchyshen, 2006, p.9). These declines are attributed to consolidations through mergers or acquisitions as credit unions struggle to survive in the extremely competitive financial services marketplace; however, the consolidations are not responsible for increasing new membership growth.

BC has also experienced a significant consolidation in the number of credit unions in the province. Since 1990, there have been 67 mergers or acquisitions. Vancity had two mergers in 2005 and another in 2007, and CCS' last merger was in 2002. (See Appendix 3 – History of Mergers for British Columbia Credit Unions). Mergers are not allowed between the country's nine chartered banks.

The most recent merger in BC was announced in April, 2007, between Prospera and North Shore (Vancouver Sun, April 18, 2007). This merger will form the third largest credit union in BC with assets of $4 billion, 100,000 members, and 28 branches. This is geographically significant because Prospera is located in Abbotsford, west of Vancouver, and North Shore is located in North Vancouver. North Shore has $1.2 billion assets, 12 branches, and 40,000 members. Prospera has $1.6 billion assets, 16 branches, and 60,000 members. North Shore had an earlier merger in 2003

"We will continue to see consolidation in the Canadian credit union system over the next few years... The major forces behind the trend of consolidation are the need to offer a greater variety of services and to find ways to achieve economies of scale" (Leshchyshen, 2005, p. 5).

### 1.3.5 Credit union centrals: strength in numbers

National and provincial trade associations play a key role in the cooperative model for credit unions. Credit unions in Canada are chartered at the provincial level. Each province has a provincial central association that provides services and resources to credit unions in their province.

At the national level, Credit Union Central of Canada (CUCC) plays a central role as the national voice and national services provider for the ten provincial centrals. CUCC monitors and maintains a system-wide liquidity pool designed to maintain financial stability within the system.

In addition, CUCC helps "credit unions achieve competitive advantages in service improvements, training and knowledge sharing."[14]

At the provincial level, CUCBC is a credit union marketplace providing core financial services, trade association services, credit union development services, and technology solutions to its members. Acting as a central banker, CUCBC provides liquidity and other treasury and financial services to its members. It is also a technology innovator through its MemberDirect™ product line of online banking and Internet solutions for consumer and business customers. These technology services provide not only economies of scale for credit unions, but offer a forum for sharing ideas and the costs of further technological innovation. (See Appendix 6 – Technology and Payment Services of CUCBC).

The Government of Canada regulates the national and provincial centrals. Both the national central, CUCC, and the individual provincial centrals, are chartered and regulated under the Cooperative Credit Association Act. The assets of depositors with credit unions are protected through provincial deposit insurance corporations. For CCS, member accounts are protected by the CUDIC of British Columbia.

In 2006, 528 credit unions and caisse populaires were members of credit union centrals with an average asset size of $165 million and an average membership of 9,200. (See Appendix 1 – Fourth Quarter 2005 Provincial Credit Union Results). CCS is a member of CUCBC.

### 1.3.6 Merger of BC and Ontario centrals

For the first time in Canadian credit union history, two credit union centrals have announced plans to merge. CUCBC and CUCO plan to merge by October 1, 2007, to form "a new co-operative financial powerhouse" with combined assets of $7.4 billion (Blackwell, 2007). The intention of the merger is to increase efficiency and effectiveness through economies of

[14] Credit Union Central of Canada. Retrieve July 7, 2007, from http://www.cucentral.ca/WhoCentral.

scale, improve buying power positions with suppliers, cut costs, decrease spending on technology, and speed decision-making processes. In 2006, CUCO had $2.4 billion in assets and CUCBC had $5.2 billion. CUCBC will take over the assets and liabilities of the CUCO and the assets will be located in BC, although offices will be maintained in both provinces. CUCO will require approval of the Ontario legislature for the merger to occur.

The online banking expertise developed by CUCBC will be pushed to the Ontario system and "Ontario's skills in offering syndicated loans to commercial customers will be exported to BC" (Blackwell, 2007). Advantages are also expected to be obtained by offsetting the differences in economic cycles between the two provinces. At the core of the initiative is the desire to form a single, national credit union system that will compete against banks in a "pan-national entity." Other provinces will be invited to join the new organization.

This merger will unify 52 credit unions in BC and 172 in Ontario, creating a membership base of over 2.76 million customers or 57 percent of credit union members in Canada. This will allow credit unions in both provinces "to cut their costs, spend less of expensive technology, and make decisions faster" (Blackwell, 2007). This merger does not mean that credit unions can operate outside their provincial boundaries.

## 1.4 Overview of Coast Capital Savings

CCS is the merger of three credit unions. CCS was formed with the merger of Richmond Savings in Richmond, BC, and Pacific Coast Savings on southern Vancouver Island in December, 2000. The two credit unions were approximately the same size at the time of the merger with $1.9 billion in assets and $1.3 billion in assets, respectively. The merger resulted in combined assets of $3.2 billion and 200,000 members. Both credit unions felt they were "ideal merger partners" and the action was a "merger of equals" (Coast Capital Savings [CCS], 2000, p.4-5).

The second merger occurred in June, 2002, when CCS merged with Surrey Metro Savings Credit Union. CCS had approximately $3.4 billion in assets and Surrey Metro Savings $2.7 billion at the time of the merger. This merger created the second largest credit union in Canada with $6.1 billion in assets and 300,000 members. Geographically, this merger extended branch services beyond the Lower Mainland into the Fraser Valley as far east as Chilliwack, BC.

### 1.4.1 Products, services and subsidiaries

CCS offers traditional, retail financial products and services to individuals and small businesses. This includes savings and chequing accounts, credit cards, mortgages, personal loans, lines of credit, registered retirement savings plans, term deposits, and US chequing accounts. Other services include, but are not limited to, wire transfers, foreign currency, travellers cheques, drafts, safety deposit boxes, and night deposit service.

In addition, small businesses have access to specialized merchant services, equipment financing, and letters and lines of credit. CCS' *Big Perks for Small Business*™ program provides special courier, printing and copying rates to small businesses through relationships with FedEx Kinko's and other courier companies.

CCS owns and operates three wholly owned subsidiaries. Coast Capital Investments is a mutual fund dealer that provides mutual funds and financial services to CCS members. CCS also offers its members online brokerage services through a partnership with Qtrade Investor so members can buy and sell securities on their own. CCS offers more than 1,200 mutual fund products and employs 94 investment advisors.

Coast Capital Insurance Services Ltd. offers general insurance products to both individuals and businesses. These products include life and disability insurance, automobile, motorcycle, home, travel, marine and recreational insurance. Business insurance is available for

commercial property, commercial general liability, equipment breakdown, and other business related products and services.

Coast Capital Equipment Finance Ltd. is a subsidiary specializing in leasing commercial and industrial equipment. Unlike the other two banking-related subsidiaries, the leasing subsidiary is able to provide services in all ten provinces.

The scope of this study is limited to the retail banking products and services division of the CCS. The three subsidiaries are not analyzed independently from the organization as a whole. Income from the subsidiaries is reported under "Other income" in the credit union's annual reports making it difficult to analyze the subsidiaries as independent business units.

#### 1.4.1.1 Product delivery

CCS' delivery of new and existing products and services is through a multi-channel approach called the Distributed Network Model (DNM). The major tenet of the DNM is that each member will receive the same levels of products and services through every delivery channel, be it in person at a branch, online over the Internet, over the telephone to the Contact Centre, or through an automated bank machine (ABM). This requires a significant investment in technology. Information from vertical business units, such as banking, insurance, and wealth management, must be processed and presented identically to each delivery channel. The member's experience is designed to be comprehensive and seamless across the channels.

The most important delivery channel in the last six years had been through Internet banking. According to the Canadian Bankers Association, transaction growth in online transfers and bill payments increased 500 percent between 2000 and 2005. The increase from 2004 to 2005 was 24.8 percent.[15] In the same year, ABM usage decreased 4.8 percent and telephone banking

[15] Canadian Bankers Association. Retrieved June 7, 2007, from http://www.cba.ca/en/content/stats/delivery%20channels%202005_eng.pdf.

decreased by 6.7 percent for the same two transactions. The increase in the use of Internet banking has had a significant impact on bank and credit union strategies beyond transfers and bill payments. This paper will present other Internet-based technologies influencing financial institutions.

CCS is also part of The Network Exchange, a network of 2,100 ABMs that is shared with other credit unions and HSBC Bank of Canada. CCS' membership in this network has eliminated ABM transaction fees for CCS members using the ABMs of other credit unions and HSBC.

### 1.4.2 Current initiatives in support of the strategic plan

CCS' growth since the merger with Surrey Metro Savings in 2002 has been through the development of new products and services, and an extension of the corporate brand through the design and construction of new retail branches. This section discusses these recent initiatives. Section 1.5.8 analyzes these initiatives as competitive strategies.

#### 1.4.2.1 New products

In January, 2005, CCS created a free chequing account product called the "Free Chequing, Free Debit and More Account™." This product has no monthly fee or minimum balance requirement and includes, among other features, free debit card transactions. CCS attributes this new product for attracting 51,000 new members to the credit union since the introduction of the product.

In 2006, CCS eliminated the interest rate negotiation process members encounter when applying for a mortgages and acquiring a term deposit product. CCS' "Haggle-free Guarantee™" means that members obtain the best rate that CCS can offer to the member at that point in time for a mortgage or term deposit.

#### 1.4.2.2 Small business initiative

CCS launched a new initiative in 2006 called *Big Perks for Small Business*™ targeted at small business owners in the Vancouver area. In addition to the aforementioned benefits, CCS announced new two products designed to eliminate or minimize transaction fees for small businesses. One product, a business chequing account, offers unlimited deposits, withdrawals, and transfers for a flat, monthly fee of $20. The second product has no monthly fee, unlimited deposits and charges $0.75 per withdrawal. The account is targeted at small business with low transaction volumes. This product is specifically designed to reduce the cost for businesses that cash many customer cheques.

According to CCS, "The two new accounts will cost the credit union $4.5 million in business banking revenues over the next three years but extra deposits will reduce its cost of borrowings and allow it to make a bigger spread on more loans" (Kane, 2007, p. D3).

CCS is hoping to see similar returns to that of the free chequing product it introduced in 2005. With the free chequing product, CCS lost $2.4 million in account service charges, but saw an increase of $3.3 million in fund commissions for a net of $900,000.

#### 1.4.2.3 New branches

Brand innovation has come in the form of a new branch concept called the "aperio store." An aperio store is a complete redesign and relaunch of the traditional, brick-and-mortar bank building. The aperio store provides an "open and accessible, customer-owned space" that offers a "retail-approach to customer service."[16] New retail outlets will be built to the aperio model and existing branches will be converted in the long run. CCS opened three aperio stores in 2005 and two in 2006 in the greater Vancouver area. CCS plans to open its 50th branch in 2007.

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[16] Coast Capital Savings (CCS). Retrieved Nov. 15, 2005, from http://www.coastcapitalsavings.com/Community/AboutUs/MediaCentre/NewsReleases/June13,2005

The characteristics of this model include stand-alone kiosks instead of teller lines, greeters focused on building customer relationships, and private consultation rooms. The customer is offered a single point of contact with no apparent visible division between services, such as banking, insurance and investments. The overall focus of the new branches is building customer relationships instead of merely processing transactions. Emphasis is placed on merchandising and promotion with colourful product and multimedia displays.

### 1.4.3 Summary

CCS' innovative product and service offerings have significantly increased its membership base, making it the largest credit union by member size in the country. However, CCS' strategy to expand to all ten provinces, and compete on the same turf as the banks, is limited by the current regulatory framework.

The structural and financial differences of banks and credit unions play a significant role in the development and execution of strategy, and arenas of competition. It is not known what impact, if any, the merger of CUCO and CUCO will have on inter-provincial, credit union activities.

Credit union consolidation continues to be a significant strategy for growth, although CCS has not been involved with mergers and acquisitions activity since 2002.

## 1.5 Competitive strategies: A review of the literature

There are both generic and specific competitive strategies that can be applied to the retail banking industry. It is important to understand these strategies as a theoretical and practical basis for individual institutional strategies. Some of these strategies form the basis of the strategic alternatives in this paper.

This section presents Porter's (Bank Administration Institute [BAI], 2005a) views on differentiation and segmentation strategies in the banking industry. The specific retail banking strategies of Croxford, Abramson, and Jablonowski (2005) are presented, and Pleshko and Souiden (2003) evaluate the product growth strategy versus the market growth strategy. The particular strategy chosen has a direct impact on customer profitability and, hence, the net interest income of a bank or credit union.

Section 1.5.8 analyzes the product and service initiatives of CCS in the context of these competitive strategies.

### 1.5.1 Customer profitability in retail banking

The economics of retail banking are based on customer profitability. This profitability involves the management of the costs to sustain the bank, customer-sustaining costs and transaction costs. Banks generate revenues from fee income (late payments, overdrafts, tiered products, etc.), interest from loans, and investment income that has been generated by use of net interest income. Banks incur customer costs in the form of interest paid on deposit accounts (chequing, savings, guaranteed investment certificates, etc.), transaction related costs (channel costs, etc.), and fixed costs, such as property, plant, and equipment, that are not transactional in nature. This cost structure creates a relationship between customer transaction behaviour and the bank's activities and resources directly involved in that transaction.

Frei and Campbell (2006) have shown that transaction costs are proportional to the channel utilized and the bank's resources required in performing the transaction. Ranked from the lowest to highest average cost per transaction were Internet, personal computer banking, ABM, call centre or telephone banking, and using a full service branch. The full service branch channel was 100 times more costly per transaction than the Internet.

There are two approaches banks can take when analyzing their channel transaction volumes. First, they can push customers to using lower cost channels by increasing fees to use higher cost channels. Second, they can push as many branch activities into the cheaper channels making it more convenient for customers to use the lower cost channels.

#### 1.5.1.1 The profitability problem

Many banks accept what is called the "80/20" rule meaning the 80 percent of the banks profits come from 20 percent of its customers. However, Frei and Campbell (2006) have shown this varies considerably. Some estimates are as high as "150/20" and other findings suggest 40 percent of customers are profitable contributing 300 percent while the other 60 percent of customer are destroying 200 percent of the value. This destruction of value is caused by over use of banking services relative to the customer's assets. Frei and Campbell (2006) showed that "the contribution of individual customers to bank earnings varied widely with a small percentage of customers cross-subsidizing the profitability of the bulk of the customer base" (p. 6).

#### 1.5.1.2 Managing customer profitability

Frei and Campbell (2006, p. 7) found that banks offered several methods for managing customer profitability, including 1) tiered services, 2) pricing initiatives, fees and cross-sell programs, and 3) branch consolidation.

Tiered services included offering customers with higher balances better interest rates and lower transaction fees. However, they were offset by the fact that higher balanced accounts were frequently more costly to service. The danger with tiered services is the risk of losing customers in the lower tiers because of their perceived value to the institution. Banks found that the lower tier customer often generated more fee income than the higher tier customers generated.

Pricing initiatives, fees, and cross-sell programs are often designed to push customers to lower cost channels, thus increasing customer profitability. Eliminating fees on account transaction usage has been a successful strategy for CCS in attracting new customers. However, creating channel neutrality for the customer may not increase their profitability.

Branch consolidation may also increase customer profitability through cost savings. However, according to Frei and Campbell (2006), customers do not feel electronic channels are a suitable alternative or substitute to a network of branches. Ironically, increasing the number of branches also increases the convenience of using them, especially drive-through windows, taking people away from lower cost channels.

### 1.5.2 Porter on differentiation and segmentation

Porter (BAI, 2005a) has argued that sustainable competitive advantage for banks comes from differentiation. A cost leadership strategy requires banks to serve all customer segments that require customer segmentation tactics in the area of products and services. A comprehensive customer segmentation strategy is difficult to design and execute, especially for frontline staff. Instead, Porter (BAI, 2005a) suggests that banks identify a particular segment to serve and then design and deliver solutions to that segment.

Porter (BAI, 2005a) adds that customer segmentation may be difficult to achieve for some banks who are "'trapped' by legacy customers, legacy geography and legacy delivery systems." Even after a merger, banks may feel it necessary to retain all the acquired customers, although not all of the customers match the customer profiles of the strategy behind the merger. Banks may be forced to face the paradox of "shrinking the opportunity in order to grow the business." Porter (BAI, 2005a) suggests focusing on "the customers you can be serving, not the ones you shouldn't be serving."

### 1.5.3 The relationship market and utility market

The BAI (2005b) observes that not all bank customers want relationships with their financial service providers. In fact, those that want a relationship "tend to be older, have with more resources and higher brand loyalty." The BAI calls this the "relationship market." The other market is called the "utility market." This market tends be younger, with few resources, and low brand loyalty. This poses problems for networked branching, especially when the branches offer a diversity of services. Banks tend to focus most of their efforts on the relationship market. As a result, the utility market has become a strategic dilemma for networked banks.

What is the result of the dilemma between the relationship and utility markets? Specialized competitors have begun to identify and target the unique preferences of each of these markets, especially the utility market. The utility market wants basic services and "a good deal." The problem for the networked banks, of course, is how to do this economically.

One insight from the BAI research is that the utility market is "insistent upon above-market rates on deposits and highly sensitive to fees. They were far less price-sensitive on credit" (BAI, 2005b, p. 6). This means that margins are available in the utility market. Segment sensitivity requires that networked banks answer the questions: What is the differentiated value we can offer to our prime customer groups? Can we tailor offerings to those groups cost effectively?

### 1.5.4 Croxford and the retail banking model

Croxford's et al. (2005) book entitled *The Art of Better Retail Banking* provides a number of strategies for both established and *de novo* banks[17]. The five major competitive variables in the banking industry are service quality, brand, products, services, and bank costs (or pricing). Banks should develop their strategies around these variables.

[17] A *de novo* bank is one that has been in operation for five years or less.

Of these five variables, Croxford et al. (2005) feels that the three most important are products, services, and price, including rates, fees and penalties. Brand differentiation in banking is diminishing, especially in the area of lending activities, like mortgages and credit cards, where niche banks and monolines have entered the marketplace. Traditional functions of a bank are now being disaggregated. Croxford et al. (2005) state, "The value of brand and large size is diminishing. The importance of regulators…is growing" (p. 246). As such, service and customer experience become important differentiators.

Croxford et al. (2005) argue that existing banks will not change their models. This means that there are two possible paths for them to follow: "more of the same, or better banking" (p. 211). Better banking, therefore, is the only competitive path. *De novo* banks, on the other hand, can offer more uniqueness because they are not constrained by old models or traditions.

"Society is evolving faster than banks. As service institutions in an increasingly service-oriented society, banks will have to evolve at the same speed as the society in which they operate" (Croxford et al., 2005, p. 97). The future for banks will require "achieving the same or similar things differently" by also working differently – not harder or smarter (Croxford et al., 2005, p. 85). Doing the right thing may become more important than how well it is executed.

"The best strategy for an established bank, and one that can hardly be disputed, must be to work towards getting their cost structure into an optimal shape, and thus to have the financial flexibility, courtesy of the reduced costs, to retain market share" (Croxford et al., 2005, p. 171). Once a bank's cost structure has been optimized, Croxford et al. (2005) suggest that an evolutionary approach to bank progress has proven to be the best practice over the years. Croxford et al. (2005) describe four strategies that have proven to be effective:

- Acquisition and consolidation – the safest route to growth.

- Improve the status quo - cut costs, improve efficiency, reduce risk, sharpen marketing, gain a better understanding of customers, staff training, outsourcing, sell poorly performing businesses, open or close branches, enhance systems, improve processes and procedures, et cetera.

- Diversify and/or specialize – focus on core competencies.

- Be a fast follower (p. 164-165).

For existing banks, organic growth is a key strategy for the long term. Banks grow as customers' assets grow. With organic growth, banks want to increase revenue through customer growth or create new products that existing customers are willing to purchase through cross-selling initiatives. Many banks are losing market share unless they engage in merger and acquisition activities. One can only assume that these banks are missing market opportunities.

### 1.5.5 Product growth versus market growth

Pleshko and Souiden (2003) studied two growth strategies employed by 325 credit unions in Florida: product growth and market growth. They examined how each strategy affected credit union profitability. The results of their study indicated that a "product growth strategy has no impact on profits but that market growth strategy does significantly affect profitability" (Pleshko and Souiden, 2003, p. 258).

Creating and launching various products and services eventually reach their profitability limits, unless cost reductions can be found through technology or other strategies. Pleshko and Souiden (2003) also found that the product growth strategy and the firm size did not have an impact on profitability either. Therefore, in order to increase profitability, credit unions must "move into new markets, develop new services, or diversify into related areas" (Pleshko and

Souiden, 2003, p. 264). "Credit unions that implement growth strategies focusing on new market segments will be the most profitable" (Pleshko and Souiden, 2003, p. 264).

The Pleshko and Souiden (2003) note that significant levels of product offerings draw customers into retail operations and the increased utilization of the facility raises profits. They conclude that focusing on "new markets only (and not current markets or both new and current markets) has a significant impact on profitability" (Pleshko and Souiden, 2003, p. 264).

### 1.5.6 Merging is not strategy

In a 1998 meeting with the BAI (see Kinkerman, 1998), Porter argued that merging is not a strategy. Porter feels that bank mergers are really only designed to achieve operational efficiency by lowering unit costs and offering services more efficiently. He is sceptical regarding economies of scale as a means of improving efficiency for banks. He argues that outsourcing of "scale-sensitive functions" and "modern information technologies are diminishing the importance of scale." Although Porter agrees that "some mergers and acquisition provide genuine opportunities to create value and improve efficiency," they should be based on economic reality and improve a bank's competitive advantage.

In 2005, Porter argued "that mergers are opportunities to really confuse actual company performance" (Cline, 2005). He admits that there is pressure on many companies, not just banks, to focus on short-term performance. Often mergers accelerate the premiums paid to shareholders or create opportunities for write-offs and charges. For these reasons, Porter feels that scale is overrated. Instead, Porter believes that competitive advantage for banks resides in a strategy of differentiation.

### 1.5.7 Coast Capital Savings' strategy

CCS' current competitive strategy has components of both low cost and differentiation. The low cost strategy is exemplified in two areas of the product spectrum. First, CCS' "Free Chequing, Free Debit and More Account™" eliminates monthly service charges and minimum balances on chequing accounts. This strategy is designed to penetrate the younger, utility segment of the market which is highly sensitive to fees. Second, CCS' *Big Perks for Small Business*™ targets small business owners with no-fee and fixed-fee accounts.

CCS' differentiation strategy can found in the new branch or "aperio store" model. An aperio store is a complete redesign and relaunch of the traditional, brick-and-mortar bank building. The aperio store provides an "open and accessible, customer-owned space" that offers a "retail-approach to customer service."[18] New "retail outlets" are being built to the aperio model and existing branches will be converted over time.

The new branch design creates an opportunity to attract the older, relationship segment of the market which is interested in more than transaction processing from their bank. One of the goals of differentiation, according to Porter, is to create brand loyalty. Brand loyalty means customers are less sensitive to price which yields higher product margins and greater net interest income. Attracting the relationship market can help CCS to achieve those margins.

Is CCS "stuck in the middle" between low cost leadership and differentiation? Porter (1985) says a company that chooses more than one generic strategy, but fails to achieve any of them, gets stuck in the middle with no competitive advantage. Porter (1985) states, "Achieving cost leadership and differentiation are usually inconsistent, because differentiation is usually costly" (p. 18). For CCS, the cost of building new branches and remodelling old ones is the price of differentiation.

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[18] CCS. Retrieved July 7, 2007, from http://www.coastcapitalsavings.com/Community/AboutUs/MediaCentre/NewsReleases/June13,2005.

But, CCS' no-fee personal and business accounts are also differentiators in the marketplace: no other financial institutions in BC are offering no-fee products. Porter (1985) observes that "anything a firm can do that lowers the buyer's total cost of using a product or other buyer costs represents a potential basis for differentiation" (p.135). It can also be argued that no-fee accounts represent a differentiation strategy, as well as a low cost strategy, because there is a cost associated with implementing the products: the loss of account fees.

One of the caveats about being stuck in the middle is that the firm fails to achieve any of the generic strategies. Whether or not no-fee accounts are viewed as a low cost or differentiation strategy, they have been a very successful in attracting new customers and it cannot be considered a failed strategy. The construction of five, new aperio branches in the last two years has also been a successful differentiation strategy in contrast to competitors with traditional, transaction-oriented, brick-and-mortar branches.

If no-fee accounts are deemed a low cost strategy, under what conditions can a company simultaneously achieve both low cost and differentiation strategies? Porter (1985) says there are three scenarios under which both of these strategies can be pursued:

- Competitors are stuck in the middle.
- Cost is strongly affected by share or interrelationships.
- A firm pioneers a major innovation. (p. 19-20).

Competitors that are truly stuck in the middle are generally weak competitors. As will be shown in the next section of this paper, CCS faces very capable competitors in both the banks and other credit unions. Likewise, CCS cannot claim to have a "big market share advantage" over its competitors, particularly the banks. However, CCS appears to be a major innovator when it comes to product development and branch design. Although Porter (1985) considers innovation

in terms of technology, he does say that "innovative new practices unconnected to technology" can also allow firms to achieve both strategies (p. 20).

CCS' strategy is primarily one of *disruptive differentiation*. Like disruptive innovation through technology, CCS has used products and branches to innovate the industry. Disruptive differentiation is considered "low-end disruption" because it targets customers who do not need the value or services offered by the high-end market, i.e. the chartered banks.

Because competitive imitation is a risk to both low cost and differentiation strategies, CCS may be forced to make a tradeoff between the two strategies in the future. Therefore, when CCS creates its next innovation, the design should emphasize either cost or differentiation. Even though CCS has currently succeeded with both strategies, Porter (1985) says "a firm should be prepared to choose what its ultimate competitive advantage will be and resolve the tradeoffs accordingly" (p. 20).

# 2 External Analysis: Go Big and High Tech

The external analysis examines the competitive forces in the financial services sector, particularly among deposit-taking institutions. The analysis has taken the perspective of credit unions entering and competing in the marketplace against other credit unions, banks in particular, and large financial institutions in general.

Michael Porter's (1979) Five Forces that drive industry competition are the threat of new entrants into the industry, the threat of substitute products and services, the bargaining power of buyers, the bargaining power of suppliers, and the rivalry among competitors. This framework allows organizations to find competitive strategies to use against their rivals and identify key success factors (KSFs) in their industry. A sixth force, government, has a significant influence on the financial services industry and it is therefore included in this analysis.

KSFs are the necessary conditions for success in a given industry. KSFs are used as determinants for corporate strategy, product and service development, identification and nurturing of corporate competencies, relationships with government bodies, and ultimately the drivers for financial success. Financial institutions are sophisticated organizations with complex internal structures, customer relationship, product and services, and government regulations. As such, there is the potential for many KSFs to be attributed to each of these areas, such as sophisticated financial and risk management, strategic vendor alliances, competitive pricing models, customer satisfaction, et cetera.

## 2.1 Threat of new entrants

The threat of new entrants is moderate. There are significant barriers to entry into the financial services sector, but not for Internet-only competitors. For credit unions in particular, economies of scale, the regulatory framework, and the high cost and use of technology in the industry are the three primary barriers. Table 2-1 summarizes the main factors facing new entrants into the financial services sector and the threat they pose to existing institutions.

**Table 2-1: Threat of new entrants matrix**

| Factors | Yes (low threat) | No (high threat) |
|---|---|---|
| Economies of scale | X | |
| Significant government policy and regulation | X | |
| High use of technology and specialized technical expertise | X | |
| Proprietary product differences | | X |
| Established brand identities | | X |
| High customer switching costs | | X |
| High capital requirements | X | |
| Difficulty in accessing distribution channels | | X |
| Industry experience leads to continuously lower costs | X | |
| Difficulty in obtaining skilled people, materials and suppliers | | X |
| Proprietary products and services offer lower costs | | X |
| Strong retaliation upon entering the market | X | |

*Source: Adopted from Professor Ray Suutari, Wilfrid Laurie University.*

### 2.1.1 Economies of scale

Economies of scale are a KSF for credit unions. Economies of scale are designed to lower average costs by increasing output or production. Costs are minimized by "producing multiple

outputs using multiple inputs." For banks and credit unions, the inputs are capital, labour and deposits, and the outputs are loans. In 2005, Allen and Liu (2006) studied the six largest banks in Canada and showed that "unit costs fall as output increases" (p.81). They also found that "larger banks appear to rank higher in efficiency than smaller banks" (Allen and Liu, 2006, p. 81). In their 2006 study, Allen, Engert and Liu compared US and Canadian banks and again found that Canadian banks "gain in terms of efficiency benefits from becoming larger."

Kohers and Mullis (1988), in a sample of 16,000 US credit unions, found that large credit unions operated more efficiently than smaller ones and "provided substantial evidence to suggest the existence of economies of scale in the industry" (p. 1657).

Goddard, McKillop and Wilson (2002) studied 7,600 US credit unions and found that larger credit unions grew faster than smaller ones during the 1990s. They noted that there is more variability in growth among smaller credit unions than larger ones. The factors favouring growth included less restrictive charters, i.e. regulatory framework, and operational efficiency. Larger credit union tended to grow faster "because they were more efficient, or because they had lower capital or bad debt ratios" (p. 2354). Goddard et al. (2002) also found a higher growth correlation between assets than membership size. "The advantages of larger credit unions derived more from being able to increase business with existing members than from being able to attract new members" (Goddard, 2002, p. 2353).

Pille and Paradi, in a 2002 study of credit unions in Ontario, determined that size matters as it relates to credit union failure. They found that a small credit union might have a large portion of its loan portfolio tied up in a few large mortgages. The risk of default on a few large mortgages could wipe out the smaller credit union.

### 2.1.2 Significant government policy and regulation

The regulatory framework is a significant barrier to entry, but it is not considered a KSF for the same *type* of institution because neither new entrants nor existing institutions can use government policies and regulations as a competitive advantage. In other words, new credit union entrants and existing credit unions play by the same rules. The regulatory framework, however, does create competitive advantages between different types of institutions, like banks and credit unions.

Changes to the regulatory framework have lowered the barriers of entry for foreign banks, increasing pressure on domestic banks, but holding the potential to affect credit unions' share of the market. On the side of credit unions, the government, in 2006, in order to increase the efficiency of credit unions and encourage new entry, proposed to decrease the number of credit unions required to establish an association under the Cooperative Credit Association Act to two from the previous minimum of ten and introduced a deposit insurance opt-out regime for associations that do not accept retail deposits.[19] Intended to lower the regulatory barriers for credit unions, this has had no impact on the creation of new credit unions as consolidation continues at rate of nearly ten percent per year.

The rules and regulations to form a credit union in British Columbia are described in three pieces of legislation: the Credit Union Incorporation Act, Financial Institutions Act and the Company Act. The application, evaluation and approval process is managed through the Financial Institutions Commission (FICOM) of BC.

At a high level, the requirements for forming a credit union are an adequate capital base, a formal business plan and a minimum five-person board of directors who all subscribe to shares

[19] Department of Finance Canada. *2006 Financial Institutions Legislation Review: Proposals for an Effective and Efficient Financial Services Framework.* June, 2006. Retrieved July 7, 2007, from http://www.fin.gc.ca/activty/pubs/White06_1e.html#Framework.

in the new credit union. A minimum of $1 million in capital is recommended, but it is required that there be sufficient evidence that the credit union will be sustainable through a five-year start-up period. The business plan must include a financial plan, a market analysis and comprehensive marketing plan, proposed locations, a list of products and services, an information technology plan, managerial experience in executing the business plan, an organizational chart, a hiring time line, et cetera. It should be noted that the Credit Union Deposit Insurance Corporation does not protect shareholder's equity shares in a credit union, only the assets of depositors.

Credit unions cannot expand beyond provincial boundaries. Gathering industry support from industry trade associations (centrals) and credit unions outside of BC is a barrier to the competitive growth strategies of some organizations, like CCS, who require the support of these groups to influence changes in federal regulations. In addition, credit unions are at a distinct disadvantage in their ability to compete against banks because they cannot access equity markets to raise capital for expansion.

Allen and Liu (2005) referenced Murray and White's 1983 study of 61 credit unions in BC. Murray and White (1983) suggested that current credit union legislation that limits the growth and diversify of credit unions raises their operating costs. Specifically, Murray and White (1983) looked at the production technology of credit unions where computers were used for at least 25 percent of their transaction posting activities and found that "economies of scale exist in most of the credit unions." "Large, multi-product credit unions are more cost efficient than small, single-product credit unions. Regulations that inhibit growth and diversification are therefore inimical to market efficiency" (Murray and White, 1983, p. 901).

### 2.1.3 High use of technology and specialized technical expertise

Information technology is a KSF for financial institutions. The use of technology is ubiquitous in all aspects of a credit union's operation, from transaction processing to financial modelling. Almost every strategic initiative has an IT component.

Information technology is also a barrier to entry for many potential credit unions. As noted by Freedman and Goodlet's (2002) report to the Bank of Canada, "there continue to be barriers to the use of information technology by financial service providers in the innovation of products and services and their delivery channels" (p. 58). Freedman and Goodlet (2002) identify several significant barriers to the use of IT. First, introduction of new technologies, such as electronic signatures and electronic documents, must wait for legal and regulatory frameworks to be created before the technologies can be implemented. Second, developments and innovations in security concepts, such as member confidentiality and authentication, are often outpaced with software systems or not compatible with company practices inhibiting or delaying adaptation of certain technologies. Three, the increased use of IT, and practices such as outsourcing, create operational risks for many financial service providers and raises regulatory issues for governing bodies such as FICOM. In other words, new technologies, specifically in the area of security, are a significant financial barrier to new entrants.

Does information technology provide profits to banks? Shu and Strassmann (2005) asked this question in their study of 12 US banks covering a nine-year period (1989-1997). The input to the study included IT budgets, non-interest expenses, interest expenses, staff costs, and other operating expenses. (Operating efficiency is the ratio of non-interest expenses to net interest income and other income). The authors measured IT productivity in relation to corporate profit. Shu and Strassmann (2005) concluded, "IT is the only input variable that provides more dollar value than the input cost on the margin when it is compared with interest expense, non-interest expense, staff cost, and operating expense" (p. 786). Although the study suggested that IT product

provide productivity gains, Shu and Strassmann (2005) caution that financial service providers are unique because of the "extraordinary dependency on IT spending compared to staff compensation costs" (p. 786).

Allen and Liu's (2005) study of Canada's six largest banks offered similar findings. Allen and Liu (2005) found that "technological ...changes are found to have had beneficial effects on the cost structure of banks. The analysis suggests that banks that adopt newer technologies are likely to be more cost-effective than using older technologies" (p. 82).

Michael Nevens, however, in an interview with Morse (2002), argues that productivity gains have largely been due to competition and innovation, not spending on IT. Nevens points out that retail banking invested heavily in IT in the 1990s. He argues that productivity did not improve because of this investment. Nevens feels that the IT investments were done to reduce labour costs, not increase revenues. Many financial service providers, for example, are unable to measure the benefits of investments in customer relationship management (CRM) systems, for example.

Nevens also thinks that creating customized product offerings increases the complexity and cost of IT systems and they did not increase customer satisfaction. He questions whether there was any real measurable return on investment (ROI) via a productivity increase with investments in technology like personal computers as workstations.

### 2.1.4 Access to distribution channels

New entrants generally have easy access to electronic distribution channels, including online banking, automated bank machines, and telephone banking. Many new entrants are choosing a single distribution channel, the Internet. As discussed earlier, existing bank customers

are increasingly using the Internet for performing financial transactions. Does that mean that new entrants will not build brick-and-mortar branches?

ING Direct, the Internet-only bank, has opened "client service locations" in Toronto, Vancouver, Montreal and Calgary.[20] These are not traditional bank branches. With the exception of cheque deposits, they do not perform any other financial transactions. Customers can obtain cash only through ABM machines located on the premises.

Building branches is a form of non-price competition, whose design and deployment has become a strategy for many financial service providers. Northcott (2004) claims that branches increase the effective size of the market and increase the scope of the competition. He shows that a branch network created by a larger bank is more competitive than a group of small banks without branches.

Although branch expansion is a form of non-price competition, not every bank or credit union can afford to add more outlets. In addition, it is often difficult to build branches in locations that are not already saturated by competitors. Credit unions, however, have been acquiring branch networks from larger banks over the last few years. Leshchyshen (2006) states:

> The expectation is that once the federal government clarifies bank merger rules and allows mergers to occur, there will be surplus branches which the federal government will require the merge bank to sell to the highest bidder. The larger credit unions across the country are preparing to mount a unified program to take any branches, asset and clients that the banks may shed because of mergers. (p. 11)

Branches become a KSF for new entrants and existing firms choosing that distribution channel.

[20] See the ING Direct website http://www.ingdirect.ca/en/aboutus/contactus/vancouver/index.html.

### 2.1.5 Other factors effecting new entrants

The section contains comments on the other nine factors, none of which represent KSFs.

- There almost no proprietary product differences in the financial sector. Products are often imitated as a form of retaliation.

- The importance of brand identity is vanishing as more competitors, particularly in niche markets, enter the sector.

- Customer switching costs are low because of intense competition. Diminished brand loyalty means customers have relationships with multiple institutions.

- Capital requirements are set high by regulatory bodies to prevent the early failure of a new entrant and apply equally to all entrants.

- Industry experience does lead to lower costs for existing institutions as they are able to gain a deep understanding of the market segments and their customers.

- Obtaining skilled people, materials and suppliers is generally not an obstacle to entry, particularly in urban areas with multiple financial institutions representing a pool of potential talent.

- As previously noted, products and services are neither proprietary nor offer lower costs. According to Porter, differentiation leads to higher costs.

- New entrants into the financial sector will face retaliation from existing firms. This has been particularly true since the entrance of foreign banks into the Canadian marketplace.

### 2.1.6 Key success factors

The three KSFs for new entrants are economies of scale, high use of technology, and branches. It is difficult for new entrants to achieve immediate economies of scale; however, innovative technology can create an immediate competitive advantage for a new entrant into the market. High use of technology also implies multi-channel delivery capabilities. It is not known whether branches will become a KSF for Internet-only entrants.

## 2.2 Threat of substitute products or services

The threat of substitutes is significant for banks and credit unions. This threat comes from not only other deposit-taking institutions, but also from monoline credit card issuers, other lending-only companies, Internet-only banks, and peer-to-peer lending networks. Many of the new substitutes operate outside the regulatory frameworks of banks and credit unions and the confines of brick-and-mortar branches. Table 2-2 lists the main factors influencing substitute products and services in the financial services sector.

**Table 2-2: Threat of substitute products or services matrix**

| Factors | Yes (low threat) | No (high threat) |
|---|---|---|
| Substitutes have performance limitations not offset by lower prices | | X |
| Substitutes have service advantages not justified by higher prices | | X |
| High customer switching costs | | X |
| Customer is not likely to substitute | | X |
| Customer has no real substitutes | | X |

*Source: Adopted from Professor Ray Suutari, Wilfrid Laurie University.*

With the increasing use of electronic delivery channels for banking products and services, and the advent of Internet-only banks, it becomes harder for customers to discern performance

limitations and service advantages, usually associated with person-to-person interactions with bank employees in branches. Prices are becoming disassociated with performance, except possibly for clients of private banks or investment firms.

Switching and search costs for consumers are low with easy access to credit through a company's telephone call centre or website. It is extremely easy for financial service companies to determine credit worthiness of customers by instantaneous access to a consumer's credit report. A customer is just as likely to switch financial institutions for convenient access to distribution channels as they are for product pricing or a free iPod[21] for opening a new account. As such, access to distribution channels, particularly the Internet, and the depth of functionality offered through that channel, has become a KSF for financial service providers.

### 2.2.1 Are banks and credit unions substitutes?

In an effort to determine whether banks and credit unions were substitutes for lending products, Feinberg and Rahman (2006) examined consumer loan rates between banks and credit unions in the US. They looked at two consumer loans products: a 24-month non-credit-card unsecured loan and 48-month new vehicle loan. They recognized that smaller credit unions must compete against larger banks in the same market. This would apply to credit unions in Canada as well.

Although banks and credit unions behave differently in the marketplace, "banks and credit unions are substitutable in the market for consumer loans." However, Feinberg and Rahman (2006) argue that they are not perfect substitutes because banks and credit unions "have unique determinants of loan rates" (p. 657). Because credit unions are non-profit organizations, they are often able to offer better rates to their members and they are often willing to take on more risk than banks.

[21] In July, 2007, TD Canada Trust bank was offering a free iPod to customers who transferred their bank account from another financial institution to them.

### 2.2.2 The rise of Internet-only substitutes

Technological innovation has been a driving force in creating substitutes and increasing competitiveness in the industry. Internet-only banks are a prime example of this phenomenon. Vancity, the largest credit union in Canada, for example, created Citizens Bank, a virtual bank with earnings from operations of $4.1 million in 2005. Citizens Bank competes directly with ING Direct, another Internet-only bank.

Technological innovation has also enabled a new model for retail banking called "peer-to-peer banking." In March, 2005, the first, peer-to-peer (P2P) banking Internet site was launched in the United Kingdom (UK) called Zopa (www.zopa.com). Zopa is an online marketplace where prospective borrowers and lenders meet in a competitive auction to borrow and lend money from one another. Zopa has been nicknamed the "eBay for loans" and Freeman (2006b) has referred to it as the "next wave of disintermediation" for banks and credit unions.

Zopa allows people come together to borrow and lend money with no institution involvement, such as a financial service provider. Borrowers create online profiles specifying the amount of and reason for loan. Usually, multiple "investors" bid on loans, by spreading the risk across 10-15 lenders. Zopa provides lenders with the borrower's credit rating and consumer-lending laws in the UK regulate them. Zopa makes one percent commission on every borrower's loan. On March 7, 2005, Zopa had 140,000 users (Wolfe, 2007a).

Although Zopa has plans to enter the US market in 2007, an equivalent P2P banking site currently exists in the United States called Prosper (www.prosper.com). Launched in February 2006, Prosper is almost identical to Zopa in what is also called a "social lending" model. Borrowers and lenders often belong to various online lending communities based on group affiliations such as religion, educational background, ethnicity, geography, alumni, et cetera.

The maximum loan amounts Prosper can mediate are state regulated with a maximum amount usually around US $25,000. In addition, there may be interest rate limitations and disclosure requirements. Interest rates vary from 8-20 percent depending upon the level of risk perceived by the lender and the stomach of the borrower.[22] "In February, 2006, Proper processed 7,200 loans funded by 295,000 separate parts" (Wolfe, 2007b). In March, 2007, Prosper had 175,000 users and US $36 million in loans.

In April 2007, Toronto-based entrepreneurs announced the creation of Canada's first online lending marketplace called CommunityLend (www.communitylend.com). CommunityLend will be modelled after Prosper and include a website and call centre. The target market is Canadians looking for lower interest rates. Greenwood (2007) noted, however, that Canadians are traditionally conservative and do not switch banks just to get lower rates online. (CommunityLend was not operational when this paper was published).

Peer-to-peer lending follows the *online auction business model*, epitomized by eBay. This business model has a number of strategic advantages, including no time constraints, no geographic constraints, large numbers of bidders (lenders) and sellers (borrowers), network economics, and they capture consumer's surplus through price discrimination.[23] Interest rates are set by the auction: the maximum rates borrowers are willing to pay. Rates are not based on the prime rate set by the Bank of Canada.

Academically, the P2P banking or social lending model is referred to as a "niche mass." Although the market is growing, Ledger (2007) feels it will not replace "the traditional financial service providers of Wall Street banking." This is partly because banks remove the risk for both borrowers and lenders by providing collateral. Unsecured lending has a high default rate:

[22] For the current rate range, see http://www.prosper.com/lend/performance.aspx.
[23] See Bandyopadhyary and Wolfe (2004) for an analysis of online auction models.

something banks have figured out. However, it may prove to be a better model than credit-card companies where customer acquisition costs and default costs are high.

As is the case in many online communities, P2P lending implies people are willing to take more risk under the assumption of trust. Does the concept of online mass collaboration, made possible due to higher and cheap bandwidths, mean more trust? It certainly means more openness among community members. It is not known how sustainable unsecured, trust-based lending will be, but its growth is certain.

### 2.2.3 Key success factors

Online substitutes, in the form of Internet-only banks, P2P lending websites, and cellphone banking, have become the primary threat to existing institutions. A KSF for existing firms is the ability to offer similar products and services of the online substitutes to their customers through the same channels. This reinforces technology as a KSF.

## 2.3 Bargaining power of buyers

The bargaining power of customers is rated moderately high due to extensive supply and variety in the financial sector, both in the form of brick-and-mortar and online or virtual institutions. Table 2-3, below, displays the factors that indicate the degree to which customers are locked into their financial service providers.

In Canada, there are a large number of customers relative to the number of financial institutions. In July, 2007, the population of Canada was estimated to be 33 million people.[24] In the same year, the Canadian Bankers Association (CBA) estimated that "99 percent of Canadians aged 18 and over have a savings, chequing or other account with a financial institution."[25] This

[24] Central Intelligence Agency of the United States. Retrieved July 2, 2007, from https://www.cia.gov/library/publications/the-world-factbook/print/ca.html.
[25] CBA. Retrieved July 2, 2007, from www.cba.ca/en/content/general/Executive%20Summary(2).pdf.

means approximately 25 million[26] Canadians have accounts at financial institutions. There are approximately 1,900 deposit-taking institutions and over 4,000 other financial service providers in Canada, as shown previously in Table 1-1.

**Table 2-3: Buying power of buyers matrix**

| Factors | Yes (low power) | No (high power) |
|---|---|---|
| Large number of buyers relative to the number of firms | X | |
| Large number of customers each with relatively small purchases | X | |
| High customer switching costs | | X |
| Low levels of buyer bargaining power | | X |
| High level of information asymmetry | | X |
| Customers are not highly sensitive to price | | X |
| Products are highly differentiated | | X |
| Strong brand recognition | | X |

*Source: Adopted from Professor Ray Suutari, Wilfrid Laurie University.*

In 2005, the CBA found that "twenty percent of household financial assets are held by banks, 11 percent by insurance companies, and 69 percent by other financial service providers."[27] According to Leshchyshen (2006), "membership of the credit union system in Canada has exceeded 10.6 million people and represents approximately 33 percent of the Canadian population" (p. 7). Credit unions are approximately 4.5 percent of the other providers. This does not mean, however, that credit unions are the sole financial providers for 33 percent of Canadians.

[26] Statistics Canada. Retrieved July 2, 2007, from http://www40.statcan.ca/l01/cst01/demo23a.htm.
[27] CBA. Retrieved June, 13, 2007, from http://www.cba.ca/en/viewDocument.asp?fl=6&sl=111&tl=&docid=451&pg=1.

Switching costs are low, with a plethora of product and service substitutes. Search and information costs are low for consumers because of vendor advertising, online access to vendor pricing models, et cetera. Only 39 percent of Canadians deal with only one financial institution. Sixty-one percent use two or more financial institutions. Thirty-five percent use two institutions, 17 percent use three, and nine percent use four or more (Ekos, 1998, p. 12). Clearly, consumers are leveraging the competitive forces in the marketplace to their advantage.

Customers are highly price sensitive, particularly with interest rates on deposit and lending instruments, and credit cards. Customer price sensitivity applies to insurance products as well and they seek to maximize their returns on wealth management products, such as mutual funds. Financial institutions are extremely sensitive to fluctuations in the prime interest rate and financial institutions must actively manage their spread. (The spread is the ratio between interest rates on loans and the interest rates deposits. Net interest income is the difference between the interest earned on loans and the interest paid on deposits. See Section 1.5.1, Customer profitability).

Products and services are generally not unique, but if they are, they can be duplicated; however, there may be a cost associated with those products that an institution is not willing to incur. (It should be noted that CCS' "Free Chequing, Free Debit and More Account™" has not been duplicated in BC). Although most institutions have recognized branding, it is not strong enough to prevent customers from switching. This is exemplified by credit card statistics.

The CBA found that there are over 550 issuers of Visas and MasterCards, and over 53 million credit cards in circulation.[28] Many of these products provide identical features, such as no annual fees and loyalty programs. A low interest rate often determines a buyer's choice of card. This is another indication of the power of buyers and the loss of significance of brand loyalty.

[28] Ibid.

### 2.3.1 Key success factors

It appears that buyers (customers) are in control of their financial destiny. Low switching costs, easy access to information, and weak brand loyalty make it easy for customers to pursue products based on the customer's sensitivity to price. Therefore, product pricing is a KSF for banks and credit unions; however, the importance of this KSF is mitigated by the competitor's ability to imitate products and services, and changes in technology.

## 2.4 Bargaining power of suppliers

The bargaining power of suppliers is moderate depending upon the degree to which institutions are their own suppliers of products and services or whether they are provided by third parties. Table 2-4, below, lists and rates the factors related to the bargaining power of suppliers.

### 2.4.1 Standardized inputs

Most suppliers to banks and credit unions provide specialized products and services to their customers. Credit unions, for example, contract with insurance companies, mutual fund companies, and credit union centrals to provide insurance and mutual fund products, and certain technology services, respectively. For example, CCS maintains a strategic relationship with Qtrade Investor to provide online brokerage services to its members. CCS does not have a brokerage division as part its organization whereas Royal Bank of Canada (RBC) has an investment division with is own online trading arm, RBC Direct Investing™. Therefore, many suppliers to credit unions must be competitive in order for credit unions to carry their products. Many of the products offered by these companies are standard, with little product differentiation.

For banks and credit unions alike, front line employees, such as tellers, insurance sales representatives, financial service advisors, branch managers, and telephone banking employees, that compose a large portion of an institution's labour supply, are easy to train and they often transfer employment regularly within the industry. In addition, unionization of financial services

employees is limited. Only one credit union in BC, Westminster Savings, has a unionized, non-managerial workforce. Employee wages are part of a financial institutions operating efficiency in the form of non-interest expenses. Because of the relative high availability of typical branch employees, institutions can keep wages low or reduce branch staff to improve efficiency.

**Table 2-4: Bargaining power of suppliers matrix**

| Factors | Yes (low power) | No (high power) |
|---|---|---|
| Inputs (capital, labour, services) are standard rather than unique or differentiated | X | |
| Quick and inexpensive to switch between suppliers | | X |
| Difficult for suppliers to enter the industry | X | |
| Difficult for suppliers to perform functions in-house | X | |
| Company can substitute inputs readily | | X |
| Many potential suppliers exist | | X |
| Business of the company is important to suppliers | X | |
| Cost of inputs has no significant influence on overall costs | | X |

*Source: Adopted from Professor Ray Suutari, Wilfrid Laurie University.*

Other segments of an institution's workplace, however, such as treasury and financial personnel, and IT workers, are highly skilled and credentialed. These skill sets and abilities require time to mature and are often in short supply. These specialized sectors of the labour force present challenges for human resource managers to recruit and retain in both banks and credit unions. As such, they have more bargaining power relative to branch employees.

### 2.4.2 Challenges for suppliers

It is highly unlikely that suppliers to banks and credit unions would enter the retail banking industry themselves, especially low-technology service providers. Because of the

regulatory nature of the financial services industry, suppliers are not structured to provide banking services themselves.

For certain suppliers, like chequing printing and paper forms companies, many potential suppliers exist and the business of the bank and credit union is important their survival. With other suppliers, like credit card processing companies, even though there may be several suppliers in the industry, it would be costly to substitute the existing service provider with a new supplier.

Credit unions, like CCS, often operate separate computer systems from different suppliers for processing core banking transactions, mutual fund transactions and insurance transactions. Each supplier must provide a competitive system, although switching costs to new software versions or to new suppliers are high. This requires credit unions to seek out less expensive IT systems and services through outsourcing, offshoring, or credit union initiatives to consolidate IT functions.

The costs of most inputs, such as labour and supplier services, have a significant influence on overall costs. IT equipment alone averages 2.5 percent of operating expenses in most credit unions.

### 2.4.3 Credit union centrals as suppliers: to serve and protect

Credit union centrals, such as CUCBC, often provide economies of scale to individual credit unions seeking technology and payment services. Although this creates a competitive advantage for smaller credit unions, it makes switching to an alternative supplier or bringing operations in-house difficult. It also limits the speed of innovation as member credit unions in the central must obtain consensus on new development and enhancements to existing technologies. Membership, however, has it advantages.

Chan and Mountain (1986) conducted a multi-provincial analysis of credit unions in Canada, with the exception of those in Manitoba and Saskatchewan. Their study underlined the importance of the co-operative structure of credit unions in the form of provincial centrals. They found there are "external economies of scale realized from belonging to central provincial credit unions." Although economies of scale were significantly different for five of the eight provinces, "the larger the provincial organization, the higher returns to scale and technological change" (Chan and Mountain, 1986, p. 221).

Technological change was also significantly different for the centrals. Larger provincial organizations resulted in higher "estimates of returns to scale and technological change" (Chan and Mountain, 1986, p.207). "Technological change has resulted in decreasing relative expenditures on loans and share capital" (Chan and Mountain, 1986, p. 221). Chan and Mountain (1986) suggest "both expansion and more centralization should be encouraged" as it increases efficiency, particularly for credit unions who are members of their provincial centrals.

### 2.4.4 Key success factors

The number and kinds of suppliers to financial institutions are many and varied. Their bargaining powers vary according the importance to the financial institution and the competitive forces in their own industries. As group, however, they have moderate bargaining powers.

Credit unions centrals provide economies of scale to credit unions, an advantage not available to banks. As a supplier, however, centrals are often not able to provide first-mover advantages to its members because of the cooperative decision-making processes inherent in the organization. There is no KSF related to suppliers. Banks' ability to be their own suppliers, especially in the area of investments services and IT, is offset by the economies of scale credit unions enjoy through their centrals.

## 2.5 Government policy reigns supreme

The power of government ranks high in the financial services industry. Government policy and regulation is a significant barrier to entry, as discussed previously in Section 2.1. Table 2-5, below, further delineates the factors surrounding government policy.

As stated earlier, credit unions are provincially incorporated and they cannot operate outside of provincial borders. This serves as a barrier to credit unions, like CCS, that would like to expand to all ten provinces in Canada. Credit union lobbying efforts will be difficult against a larger and more powerful banking lobby. In addition, the government has a "big but not too big" policy regarding banking mergers that may well be applied to credit unions should the situation arise in that sector.

**Table 2-5: Government policy matrix**

| Factors | Yes (high power) | No (low power) |
|---|---|---|
| Taxation authority | X | |
| Foreign competition regulation | X | |
| Industry regulation | X | |
| Environmental policy | X | |
| Anti-combines rules[29] | X | |

There have been efforts in the past to change the regulatory framework. In 1998, a group of twelve credit unions proposed a Community Bank model but were unable to acquire and sustain sufficient support of the credit union organization as a whole and the proposal was withdrawn. In June 1999, the government confirmed its willingness to support the credit union movement on the development of the cooperative bank concept. The Cooperative Bank Consultation Paper of 2002 proposed three cooperative bank models for credit union expansion:

[29] Includes laws regarding mergers and acquisitions, and anti-trust activities.

the national, federated, and individual cooperative bank models. Although credit union responses[30] to the paper tended to favour either the national or the federated model, none of the models was adopted because of their complexities and the failure to address satisfactorily the key principles.[31]

Other models have been proposed outside the context of the cooperative bank model. These include formation of a retail cooperative credit association, operation as an extra-provincial credit union under provincial legislation, conversion to a bank or trust under the Bank Act, or major investment in banks or trusts. Although each model has individual benefits, there are many flaws such as compliance with provincial deposit insurance requirements, differences in provincial capital and liquidity requirements, higher taxes, and adoption of complex regulatory requirements, respectively.

Regulatory changes have improved the cost structure of banks (Allen and Liu, 2005), however. In 1987, banks could invest in corporate securities and distribute government bonds. In 1992, banks could acquire trust companies and, in 1989, banks adopted minimum capital requirements. None of these cost structure changes, however, are available to credit unions giving banks a further competitive advantage.

### 2.5.1 Key success factors

There are no KSFs derived from an analysis of government policy. Government is responsible for creating a competitive balance between banks and credit unions in the financial services sector.

[30] Department of Finance Canada. Retrieved July 7, 2007, from http://www.budget.gc.ca/activty/consult/coope.html.
[31] According to Dalal (2000), Vancity withdrew its support for the initiative causing its collapse.

## 2.6 Rivalry among existing firms

Rivalry among banks, credit unions, and other financial service providers is high. The factors affecting the competitive nature of the industry are rated in Table 2-6, below.

The financial services sector is very competitive due to changes to the federal regulatory framework and technological innovations. In 2005, there were 69 banks in Canada of which 18 were domestic, and 49 were foreign bank subsidiaries and branches. For the same year, there were 1,156 credit unions and caisse populaires. Not only are there a large number of firms in the industry, but as discussed in Section 1.5, competitors are not of equal size and there is considerable specialization and niche players within the industry. For credit unions, in particular, competition has meant slow membership growth, averaging only 0.7 percent over the last five years.[32]

Banks reported $1,858 billion in assets and a return on equity (ROE) of 14.7 percent. Credit unions reported $72 billion in assets and an ROE of 11.4 percent.[33] Credit unions rely almost exclusively on net interest income for their revenue. In 2003, seventy-five percent of credit unions' revenue came from net interest income, a decrease of ten percent from 1995. By contrast, banks have seen strong growth in revenue from non-interest income, such as mutual fund and security sales, and income from foreign sources that was approximately 30 percent for banks in 2003.[34]

Competition results in the narrowing of interest rate spreads, decreasing net interest income for credit unions. The banks' higher ROE is driven not by net interest income, but rather

[32] Leshchyshen (2006, p. 8).
[33] Croxford, et al. (2005, p.50) suggest that for banks a ROE of ten percent is poor, 15 percent is good, and 20 percent is excellent.
[34] Department of Finance, Canada. *The Canadian Financial Services Sector.* June, 2005. Retrieved July 7, 2007, from http://www.fin.gc.ca/toce/2005/fact-cfsse.html.

by other income in the form of "significant fees generated from their brokerage, mutual funds and investment management activities" (Leshchyshen, 2006, p. 25).

**Table 2-6: Rivalry among exiting firms matrix**

| Factors | Yes (high rivalry) | No (low rivalry) |
|---|---|---|
| Large number of firms | X | |
| Competitors are of equal in size | | X |
| Competitors are diversified rather than specialized | | X |
| Slow market growth | X | |
| High fixed costs | X | |
| High exit barriers | X | |
| Low levels of product differentiation | | X |
| Strong brand recognition | | X |
| Low customer switching costs | X | |
| Low level of information asymmetry | X | |
| Mergers and acquisitions occur frequently | X | |

*Source: Adopted from Professor Ray Suutari, Wilfrid Laurie University.*

Fixed costs are high in the industry including building rents, branch construction, property taxes, computer equipment, automatic bank machines, furniture, management salaries, et cetera. Exit barriers are high and costly, particularly if buildings, property and equipment must be sold on the open market.

### 2.6.1 Products and services, not brand

As discussed previously, there is very little brand recognition and brand loyalty in the industry. Customer switching costs are low, partially due to low levels of information

asymmetry. Institutions offer a plethora of products, making product differentiation often difficult, especially for lending products like mortgages.

There is evidence to suggest that the credit union governance structure provides a competitive advantage. Amess and Howcroft (2001) believe the governance structure of a credit union is a competitive advantage because it "ameliorates problems associated with adverse selection and moral hazard" for members (p. 59).[35] Trust, implicit contracts, and cooperation through member election of the board are inherent in the cooperative principles of credit unions. In addition, the stakeholder theory of corporate governance "reduces problems associated with asymmetric information" (Amess and Howcroft, 2001, p. 60).

Credit unions that offer products like free chequing accounts, eliminate membership tiers so that members don't get the idea that there is hidden information regarding their status in the institution compared to other members. A single or haggle-free rate on a term or mortgage reduces problems associated with asymmetric information.

### 2.6.2 Mergers and acquisitions: the path to survival

Two trends in the financial services sector exemplify the competitive nature of the industry. First, in 1999, the federal government allowed foreign banks to establish full service branches in Canada. As result, between 1997 and 2004, the value of services provided by foreign banks increased from 5.7 percent to 7.9 percent at the expense of domestic banks that saw their value of services provided decrease 2.4 percent over the same period. Credit unions saw a slight increase of 0.3 percent. (See Appendix 4 – Market Share Increase for Foreign Banks). The decline in domestic banks can be directly attributed to the ability of foreign banks to open branches in Canada. Credit unions' increase in market share can be attributed to strong loan growth, particularly with commercial and residential mortgages.

[35] For a discussion of adverse selection and moral hazard in the insurance industry, see Weimer and Vining (2005, p. 120).

The second trend indicative of increased competition in the financial services sector is the number of mergers and acquisitions in the industry. Between 1995 and 2005, the number of credit unions decreased from 2,448 to 1,156 that led to an increase in average asset size. By 2003, mergers and acquisitions resulted in the six major banks accounting for about 76 percent of the total assets of the deposit-taking institutions in Canada. By contrast, Canada's largest credit union, Vancity had assets of $10 billion in 2005[36] and the largest bank, RBC, had assets of $470 billion.[37] (See Appendix 2 – Size of Financial Institutions in Canada). "Although, the consolidation of credit unions may be making it possible for credit unions to survive, they do not appear to be fuelling new membership growth" (Leshchyshen, 2006, p. 9).

Although mergers may be part of a credit union's strategy to increase efficiency and compete against larger rivals, research does not always support those assumptions. Ralston, Wright, and Garden (2001) studied post-merger gains in technical and scale efficiency in 31 Australian credit union mergers from 1993-94, relative to non-merging credit unions during the period 1994-95. They compared their findings to a similar study of US credit union mergers in a 1999 study. "Our findings suggest that mergers are not associated with improvements in efficiency superior to those achieved by internal growth" (Ralston et al., 2001, p. 2277). Internal growth, of course, was measured in the non-merging credit unions.

Ralston et al. (2001) were able to make the following additional observations:

- "Credit unions may better achieve the twin goals of efficiency and member service satisfaction by aligning with other small financial institutions and centralised bodies to purchase aggregated services and to outsource specialized technology support and product innovation." (Ralston et al., 2001, p. 2302)

[36] Credit Union Central of Canada. *The Largest 100 Credit Unions: Second Quarter 2006*. Toronto, ON, September, 2006.
[37] Royal Bank of Canada. *2005 Annual Report, Financial Highlights*. Retrieved July 7, 2007, from http://www.rbc.com/investorrelations/pdf/arfront_e_05.pdf

- "While mergers can potentially increase efficiency, they can reduce member satisfaction through rationalisation of staff and /or branches and from problems in the integration of systems, procedures and technology." (Ralston et al., 2001, p. 2302)

Finally, Ralston et al. (2001) suggested that credit union were better off by competing against banks, instead of merging, so that they can focus on efficiency and customer service.

Who benefits from a credit union merger: the members of the acquiring or acquired credit union? Fried, Lovell, and Yaisawarng (1999) asked this question in a study of 6,000 US credit unions involving 300 merger participants for the period 1988-1995. Their results, on average, indicated that there was 1) no deterioration in service provision to members of the acquiring credit union, and 2) an immediate improvement in service provision to members of the acquired credit union. This improvement lasts for at least three years. The aggregate findings, however, indicated that 50 percent of acquiring and 20 percent of acquired experience a decline in service provisions after a merger.

Another reason for the increase in credit union mergers is directly related to changes in the regulatory framework for banks. Worthington (2004) noted that motives for bank and credit union mergers were significantly different. Credit union motives are based on democratic or co-operative principles; banks are based on ownership or stock concentration. Conceptually and philosophically, credit unions are organized to maximise benefits to the members rather than profit maximization. However, regulatory changes, particularly in the banking industry, have increased competitive pressures on credit unions, causing a shift in credit unions orientation towards profit maximization.

There are several motivations behind merges and acquisitions in the credit union industry. One, an orientation towards profit maximization is driven by managerial objectives. Two, regulatory intervention is designed to promote stability and efficiency in the financial

services sector for the purpose of increasing capital base and operating efficiencies. Three, a common bond association, based on ideology or geography may also encourage consolidation.

The government provides regulations for both bank and credit union mergers. Provisions in the Competition Act regulate bank mergers in Canada. This policy has been simply stated as "big shall not buy big' policy." Although large banks have argued that big mergers are necessary to compete internationally, Industry Canada (1997) did not agree with the idea that "domestic mergers are the only alternative to coping with the pressures of global competition. By definition, mergers between competing banks reduce competition" (p. vi).

Credit union mergers are controlled by the Financial Institutions Commission (FICOM) of BC. FICOM (1998) recognizes two forms of credit union mergers: business acquisition or amalgamation of two or more credit unions. Under an acquisition, the selling credit union ceases to exist and the buying credit union operates as the corporate entity. With an amalgamation, a new credit union is formed and the individual, amalgamating credit unions cease to exist. Under either scenario, each credit union must hold pre-merger meetings with their members. Notice must be given to members in the form of a special resolution. Members have the right to redeem equity shares, if applicable, and individual entities require approval of equity shareholders of the transferring credit union. This process is analogous to shareholder approval for a bank merger.

### 2.6.3 Key success factors

Mergers and acquisitions have become a KSF for credit unions. Competitive pressures have led to considerable consolidation within the credit union industry, requiring many credit unions to merge in order to survive.

## 2.7 Overall industry rating

For domestic banks and credit unions, the financial services sector is not an attractive industry. The overall factors affecting the banking and credit union industry are summarized in Table 2-7, below.

**Table 2-7: Five Forces analysis matrix**

| Factors | Favourable | Moderate | Unfavourable |
|---|---|---|---|
| Threat of new entrants | | 6L to 6H | |
| Threat of new products or services | | | 0L to 5H |
| Bargaining power of buyers | | | 2L to 6H |
| Bargaining power of suppliers | | 4L to 4H | |
| Government policy | | | 0L to 5H |
| Rivalry among existing firms | | | 4L to 7H |
| **L = low power or threat H = high power or threat** | | | |

*Source: Adopted from Professor Ray Suutari, Wilfrid Laurie University.*

The threat of new entrants is moderate for existing firms. Barriers to entry, especially economies of scale and government regulations, are particularly high for new entrants. Many new entrants are Internet based and therefore do not face traditional entry barriers.

The bargaining power of buyers is moderately high, but continues to be unfavourable to existing firms. The increase in diversity of financial services, such as Internet-only banks and utility market niches, is unfavourable to existing institutions because switching costs are low.

Although the bargaining power of suppliers is moderate, credit unions reliance on technical services, such as Internet-banking hosting and development from credit union centrals, slows and limits innovation for individual member credit unions.

Rivalry among existing firms and the threat of new products and services increases competition among financial institutions. Changes to government regulations have increased the presence of foreign banks and unfettered consolidation activity among credit unions has intensified competitive forces.

## 2.8 Summary of key success factors

The Five Forces analysis has identified the four KSFs for banks and credit unions as deposit-taking institutions in the Canadian financial services sector. Mergers and acquisitions are a KSF under rivalry among existing firms. It has been included as a factor in achieving economies of scale. Technology is both a barrier to entry and a KSF for many substitutes. Product pricing is important to buyers and a firm's organic growth. Branches are important to competitors who have chosen branches as a product and service distribution channel, but they are not applicable to all competitors in the marketplace.

The KSFs are ranked in their order of importance as follows:

1. Economies of scale – efficiencies through internal growth, mergers and acquisitions.

2. Technology – creating first-mover advantages and responding to competitive threats through innovation.

3. Product pricing – innovation in product offerings and services to attract customers and achieve market differentiation.

4. Branches – a distribution channel for products and services, brand promotion and recognition, and differentiation.

## 2.9 Competitive analysis of rivals

The section contains a competitive analysis of CCS' credit union rivals. The criteria used in this analysis include financial results, products and services, branches, and information technology. Financial results are important in understanding a credit union's ability to growth market share and execute strategic plans. Products and services are indicative of a credit unions competitive strategy and areas of competitive advantage. The number and location of branches, in part, determines the geographic sphere of influence the institution has in attracting and serving customers. Finally, information technology systems and expenditures dictate the numbers and types of transaction channels available to customers and the alacrity to which new products and service can be delivered through those channels.

The five credit unions analyzed on all four criteria are CCS, Vancity, Prospera, Envision, and Westminster Savings. The financial analysis includes data on one bank, RBC, for comparative purposes. RBC is the largest chartered bank in Canada. Analyzing other banks is beyond the scope of this paper.

### 2.9.1 Competitive strength assessment

The competitive strength of a credit union is dependent upon its abilities to achieve success against the industry's key success factors and how it compares against its key rivals. The competitive strength assessment of the rivals is summarized in Table 2-8, below.

The table applies relative weights to KSFs and rivals are rated on a scale of one to ten on each KSF with ten being the highest. Rankings consider competition between credit unions and credit unions against banks. Ranks are relative to one another, based on the analysis contained in Sections 2.9.2 through 2.9.5.

**Table 2-8: Competitive strength assessment**

| KSFs | Weight | Vancity | | CCS | | Envision | | Prospera | | Westminster | | RBC | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Economies of scale | 0.30 | 8 | 2.4 | 7 | 2.1 | 5 | 1.5 | 4 | 1.2 | 4 | 1.2 | 10 | 3.0 |
| Technology | 0.30 | 6 | 1.8 | 5 | 1.5 | 7 | 2.1 | 7 | 2.1 | 7 | 2.1 | 9 | 2.7 |
| Pricing | 0.25 | 6 | 1.5 | 7 | 1.75 | 6 | 1.5 | 6 | 1.5 | 6 | 1.5 | 8 | 2.0 |
| Branches | 0.15 | 8 | 1.2 | 8 | 1.2 | 3 | 0.45 | 5 | 0.75 | 2 | 0.3 | 10 | 1.5 |
| *Score* | | | 6.9 | | 6.55 | | 5.55 | | 5.55 | | 5.1 | | 9.2 |
| **Rank** | | | **2** | | **3** | | **4** | | **4** | | **6** | | **1** |

The weight is multiplied times the rank to arrive at a relative score for each KSF for each rival. The scores for each rival are then added vertically and a rank is assigned to each rival based on their total score. For example, Vancity is ranked 8$^{th}$ on economies of scale which has a weight of 0.30. Vancity scores 2.4 on this KSF by multiplying the weight (0.30) times the rank (8).

Economies of scale are indicative of the financial strength of an institution, its efficiency, and the firm's overall position in the marketplace. Section 2.9.2, below, presents a detailed financial comparison of the six rivals in Table 2-8.

Technology is considered in terms of a credit union's alacrity in delivering new products and services to market for senior management, and to create a first-mover advantage with new technology, such as cellphone banking. Although new technologies can be easily duplicated, legacy systems are a costly liability in pursuing innovation and a technical roadblock to mergers and acquisitions. Technology also accounts for multi-channel delivery capabilities.

Asset, deposit, and membership growths are the primary indicators of the competitive pricing models of the rivals. The assumption is that customers are attracted to lower loan rates and higher deposit rates. The result is a lower net interest margin for the institution.

The number and location of branches, in part, determines the geographic sphere of influence the institution and it ability to attract and serve customers. The branch locations of credit unions are examined in Section 2.9.4, below.

RBC is ranked first, based primarily on the economies of scale it can bring to the marketplace as being the largest financial institution in the country. It has a net interest margin an entire percentage point below that of the five credit unions and a significant branch presence in the Vancouver area. RBC has sophisticated online technologies for both its banking and investment businesses. Credit union rivals do not offer their customers online access to their investment portfolios.

Vancity is ranked second and CCS is third. Vancity's assets and deposits are slightly ahead of CCS, explaining the slight lead Vancity has over CCS is the ranking. CCS consistently improves its balance sheet, has a strong branch presence in both the Lower Mainland and Vancouver Island, and is a leader in product innovation. Vancity and CCS face technological challenges due to legacy systems. Vancity, however, has an Internet-only bank that gives it a slight edge on technology.

### 2.9.2 Financial comparison

This section contains a financial analysis of the five largest credit unions in BC and the country's largest chartered bank, RBC. This analysis is important to understand how well each institution is managed financially and the impact this has on their KSFs. Key financial indicators include asset growth, net income, return on assets (ROA), return on equity (ROE), revenue

growth, operating expenses, and other financial measures. Table 2-9, below, ranks each rival according to key financial indicators for the period 2004-2005 based on the data contained in Tables 2-10 through 2-12.

**Table 2-9: Rivals financial rankings**

| Factor | Vancity | CCS | Envision | Prospera | Westminster | RBC |
|---|---|---|---|---|---|---|
| Asset growth | 3 | 1 | 2 | 6 | 5 | 4 |
| Return on assets | 5 | 4 | 1 | 6 | 3 | 2 |
| Return on equity | 6 | 3 | 2 | 4 | 5 | 1 |
| Capital % assets | 3 | 5 | 2 | 4 | 1 | 6 |
| Capital growth | 4 | 2 | 2 | 1 | 6 | 5 |
| Net interest margin | 4 | 5 | 1 | 2 | 3 | 6 |
| Net income % assets | 5 | 4 | 1 | 6 | 3 | 2 |
| Operating expenses | 2 | 1 | 5 | 6 | 3 | 4 |
| Productivity expense ratio | 5 | 3 | 2 | 6 | 4 | 1 |
| Deposit growth | 3 | 1 | 4 | 5 | 6 | 2 |
| **Total** | 40 | 29 | 22 | 46 | 37 | 33 |
| **Average** | 4 | 2.9 | 2.2 | 4.6 | 3.7 | 3.3 |
| **Ranking** | **5** | **2** | **1** | **6** | **4** | **3** |

A total of ten factors were analyzed. Rankings in each cell are a scale of one to six with one being the highest. Commentary and details of each factor follow the table.

The rankings indicate that CCS performed second overall among its rivals. Its received number one rankings in the areas of asset growth, deposit growth, and operating expenses, and it second on capital growth. Asset growth and deposit growth are indicative of CCS' ability to

increase its membership base through its new pricing model in the form of free chequing and haggle-free accounts. Its low rank on net interest margin indicates the pricing sacrifices needed to attract new customers.

If we consider the optimal structure for a credit union to be maximized retained earnings as a percentage of total capital, than CCS and Vancity are much closer to the optimal than either Prospera or Envision. Factoring in the amount of debt used to fund the business and the overall size of operations, it appears that CCS is in the better financial position than its credit union rivals. With the lowest level of debt and the highest level of retained earnings relative to total capital, CCS carries the lowest level of financial risk and likely the lowest overall cost of capital.

Table 2-10, below, indicates that CCS is the second largest credit union in Canada by asset size. Asset size contributes to a financial institution's KSF of economies of scale.

**Table 2-10: Asset growth and profitability of rivals**

| Institution | Assets ($mils) | Asset growth % | Net income ($000's) | Return on assets % | Return on equity % | Total capital ($000's) | Capital % assets | Growth in capital | Nat'l rank |
|---|---|---|---|---|---|---|---|---|---|
| Vancity | 11,756.3 | 12.4% | 56,072 | 0.54% | 10.7% | 587,725 | 5.00% | 27% | 1 |
| CCS | 8,200.5 | 14.0% | 47,136 | 0.61% | 14.8% | 362,109 | 4.42% | 31% | 2 |
| Envision | 2,410.7 | 13.7% | 20,558 | 0.91% | 17.8% | 131,308 | 5.45% | 31% | 5 |
| Prospera | 1,615.8 | 9.2% | 7,2589 | 0.47% | 12.3% | 75,498 | 4.67% | 75% | 9 |
| Westminster | 1,315.3 | 9.9% | 8,624 | 0.69% | 11.5% | 79,274 | 6.03% | 12% | 13 |
| RBC | 469,521.0 | 10.2% | 3,482,000 | 0.78% | 17.9% | 20,147,000 | 4.29% | 15% | N.A. |

*Source: Adopted from Leshchyshen (2006, p. 34).*

In 2005, CCS was the fastest growing credit union in BC and 17th fastest in the country. (The highest asset growth was 27 percent). Its ROE was the second highest among its rivals as

well as its growth in capital. Much of this growth was fuelled by an increase in membership that made CCS the largest Canadian credit union by member size at 339,890. Vancity is second by membership at 337,107 members.

Table 2-11 shows that CCS' low net interest margin is indicative of the fact that although assets grew 14 percent in 2005, term deposits increased 21 percent, thus decreasing net interest income and lowering the net interest margin. As mentioned early, this is directly related to the pricing KSF.

**Table 2-11: Operating results of rivals**[38]

| Institution | Net interest margin | Other income | Operating income | Operating expenses | Net income before loan losses | Loan losses | Income taxes | Net income |
|---|---|---|---|---|---|---|---|---|
| Vancity | 2.65% | 0.73% | 3.38% | 2.60% | 0.77% | 0.07% | 0.16% | 0.54% |
| CCS | 2.36% | 0.86% | 3.23% | 2.41% | 0.81% | 0.08% | 0.12% | 0.61% |
| Envision | 2.77% | 1.66% | 4.44% | 3.25% | 1.19% | 0.12% | 0.16% | 0.91% |
| Prospera | 2.76% | 1.57% | 4.32% | 3.61% | 0.71% | 0.12% | 0.13% | 0.47% |
| Westminster | 2.74% | 1.08% | 3.82% | 2.91% | 0.91% | 0.13% | 0.09% | 0.69% |
| RBC | 1.51% | 2.78% | 4.29% | 3.13% | 1.16% | 0.10% | 0.29% | 0.78% |

*Source: Adopted from Leshchyshen (2006, p. 43).*

CCS compares favourable with its rivals on other measures of operating results. Credit unions are non-profit organizations and pay significantly lower taxes than chartered banks, like RBC. Lower taxes create more retained earnings which can be used to increase spending on KSFs such as technology and branches.

[38] As a percent of average assets.

CCS experienced the largest growth in total deposits of it rivals in 2005 as shown in Table 2-12, below. Term deposit growth is noted particularly because of CCS significant growth in this area. Much of this growth can be attributed to CCS new haggle-free deposit offerings and increase in membership. Deposit growth relates directly to the pricing KSF because it affects net interest income.

**Table 2-12: Deposit portfolio of rivals**

| Institution | Demand deposits ($000's) | Term deposits ($000's) | Term growth % | Registered savings ($000's) | Total deposits ($000's) | Total deposit growth % |
|---|---|---|---|---|---|---|
| Vancity | 1,909,192 | 8,552,851 | 17.6% | 0 | 10,003,624 | 12.4% |
| CCS | 1,637,177 | 4,615,687 | 20.8% | 1,409,925 | 7,629,289 | 13.7% |
| Envision | 459,188 | 1,236,627 | 18.0% | 358,084 | 1,891,136 | 2.6% |
| Prospera | 367,150 | 761,922 | 4.0% | 277,934 | 1,317,006 | -0.1% |
| Westminster | 257,719 | 622,378 | 10.2% | 234,383 | 1,023,077 | -0.4% |
| RBC | 114,312,000 | 175,785,000 | 16.6% | 16,763,000 | 306,860,000 | 13.2% |

*Source: Adopted from Leshchyshen (2006, p. 40).*

The other factor in the net interest income equation is loan growth. Financial institutions seek to balance loan portfolios to generate the most revenue. Table 2-13, below, shows the loan portfolio mixes of the six rivals. Pricing models must be developed for each type of lending product. Each pricing model contributes proportionally to the pricing KSF.

**Table 2-13: Loan portfolio of rivals**

| Institution | Residential mortgage loans ($000's) | % of total | Commercial mortgage loans ($000's) | % of total | Consumer loans ($000's) | % of total | Business loans ($000's) | % of total | Total loans ($000's) | Allowance/ loans % |
|---|---|---|---|---|---|---|---|---|---|---|
| Vancity | 6,321,474 | 63% | 973,948 | 10% | 1,821,773 | 18% | 926,848 | 9% | 10,044,043 | 0.59% |
| CCS | 4,724,691 | 69% | 1,579,785 | 23% | 497,425 | 7% | 0 | 0% | 6,801,901 | 0.48% |
| Envision | 1,364,994 | 64% | 321,484 | 15% | 299,759 | 14% | 138,007 | 6% | 2,123,785 | 0.42% |
| Prospera | 834,233 | 59% | 338,988 | 24% | 230,703 | 16% | 0 | 0% | 1,404,013 | 0.44% |
| Westminster | 668,483 | 57% | 108,798 | 9% | 147,296 | 13% | 244,701 | 21% | 1,169,278 | 0.32% |
| RBC | 91,043,000 | 49% | N.A. | | 41,045,000 | 22% | 53,626,000 | 29% | 185,714,000 | 0.78% |

*Source: Adopted from Leshchyshen (2006, p. 37).*

Forty percent of CCS' loan portfolio growth in 2005 was in commercial mortgages. The figure includes business loans as well. Commercial mortgages represent 23 percent of CCS total loan portfolio. According to CCS' *2005 Annual Report,* commercial mortgages charge almost a full percentage (0.9%) higher interest rate, on average, than residential loans.

By contrast, Westminster has the largest percentage of business loans among its credit union rivals representing 21 percent of it total lending. Although most credit unions focus on residential mortgage lending, RBC has a more balanced loan portfolio and the highest allowance for loan losses, possibly representative of its higher exposure to consumer and credit card loans. (RBC had $6,200 million in credit card loans in 2005, representing three percent of its loan portfolio, but not shown in the table).

### 2.9.3 Products, services and economies of scale

Products and services have become important differentiators and cost strategies for credit unions and banks. The ability of a financial institution to offer a wide range of products and services is indicative of the economies of scale available to an institution. Large institutions, like RBC and Vancity, are able to invest in products, services and technologies that create a competitive advantage when rivals cannot offer the same products and services or offer them at a higher price. The range of products and services of the six rivals are shown in Table 2-14, below.

All of the rival credit unions offer the same, basic banking, insurance, and wealth management services. Rivals have attempted to differentiate themselves in niche service offerings. CCS and RBC offer commercial and industrial equipment leasing, and two credit unions have automobile leasing subsidiaries. Vancity and Prospera operate Internet-only banks to create an inter-provincial banking presence and to generate additional revenues.

Vancity is unique among credit unions in owning a venture financing subsidiary and being on the vanguard of micro and P2P lending in the BC. It must be noted, however, that their P2P lending is not Internet or inter-provincially based, as modelled by Zopa and CommunityLend. None the less, it should be particularly noted that the Internet-only banks and P2P lending are important as differentiators because of their roots in technology.

**Table 2-14: Products and services of rivals**

| Products/services | CCS | Vancity | Envision | Prospera | Westminster | RBC |
|---|---|---|---|---|---|---|
| Personal banking | X | X | X | X | X | X |
| Business banking | X | X | X | X | X | X |
| Insurance | X | X | X | X | X | X |
| Wealth management | X | X | X | X | X | X |
| Online banking | X | X | X | X | X | X |
| Online investments | X | X | X | X | X | X |
| Credit cards | X | X | X | X | X | X |
| Real estate and commercial lending | X | X | X | X | X | X |
| Commercial and industrial equipment leasing | X | | | | | X |
| Automobile leasing | | | X | | X | |
| Internet bank | | X | | X | | X |
| Venture financing | | X | | | | X |
| Peer lending | | X | | | | |
| Micro lending | | X | | | | X |

*Source: Credit union annual reports for 2005.*

### 2.9.4 Branches

Branches play some importance as a KSF for financial institutions. Table 2-15 shows the distribution of credit union branches in BC.

The number and location of credit union branches are important to providing products and services to customers, and extending brand awareness. It is also indicative of the economies of scale that can be leveraged with sufficient financial assets. It is clear that Vancity dominates

the Lower Mainland and CCS has an equal presence on both the Lower Mainland and Vancouver Island. There are opportunities for CCS and Vancity to extend beyond the greater Vancouver area into the interior of BC, although such an expansion is most likely to be obtained through a merger or acquiring the closed branches of banks than by building new branches.

**Table 2-15: Branch locations of rivals in BC**

| Branch locations | CCS | Vancity | Envision | Prospera | Westminster | RBC |
|---|---|---|---|---|---|---|
| Lower Mainland | 22 | 44 | 9 | 8 | 12 | N.A. |
| Fraser Valley[39] | 2 | 3 | 8 | 14 | | N.A. |
| North and West Vancouver | 1 | 4 | | | | N.A. |
| Interior BC | | | 1 | 10 | | N.A. |
| Vancouver Island[40] | 24 | 1 | | | | N.A. |
| **Total** | 49 | 52 | 18 | 32 | 12 | N.A. |

*Source: Institutional annual reports for 2005.*

RBC has 1,104 branches in Canada, but the author was not able to determine the number in BC. It should be noted, however, that RBC had 1,125 branches in 2001 and as few as 1,098 in 2004. This is a reduction of 21 branches in five years or an average of four per year. It has increased its branches in the US from 240 in 2001 to 273 in 2005 or an average of more than six per year.[41]

[39] Fraser Valley Regional District is the area east and north of Maple Ridge and Langley, beginning with Mission and Abbotsford.
[40] Island Savings Credit Union, the 20th largest in Canada and 8th in BC, has 13 branches on Vancouver Island.
[41] Royal Bank of Canada [RBC], *2005 Annual Report*, p. 1.

### 2.9.5 Information technology

Technology has been identified as a major KSF for banks and credits. All of the institutions in this study offer identical delivery channels for their products and services, including ABMs, debit cards, PC/Internet banking, and telephone banking. They all offer similar, if not identical, functionality through these channels. For example, fund transfers and bill payments are available through online and telephone banking for all of the rivals' technologies. None of the rivals can distinguish themselves with a first-mover advantage technology, such as cellphone banking. Other criteria, therefore, are used to evaluate and rank competitors: technology platforms, product development capabilities, and expenditures on technology. Table 2-16, below, illustrates the several factors related to the technology of the rivals.

**Table 2-16: Information technology of rivals**

| Institution | Technology platform | Product development | Operating expenses ($000's) | Computer equipment and software ($000s') | As a % of operating expenses |
|---|---|---|---|---|---|
| Vancity | Legacy | Custom, in-house | 261,595 | 6,366 | 2.4% |
| CCS | Legacy | Custom, in-house | 184,744 | 3,978 | 2.1% |
| Envision | Modern | Vendor releases | 73,483 | 1,839 | 2.5% |
| Prospera | Modern | Vendor releases | 55,878 | 1,000 | 1.8% |
| Westminster | Modern | Vendor releases | 20,589 | N.A. | N.A. |
| RBC | Mixed | Mixed | 11,388,000 | 682,000 | 5.9% |

*Source: Institutional annual reports for 2005.*

The first two criteria were chosen on the basis of a credit unions ability to position itself for the delivery of first-mover advantage technologies. The technology platform criterion

answers the question: Does the institution have the technical infrastructure and core systems to deliver innovative solutions? The product development criterion answers the question: Does the institution have the internal resources or vendor relationship to provide first-mover delivery of new solutions? The last criterion examines the financial resources allocated to computer equipment and software as a percent of operating expenses. This is partially indicative of an institutions overall spending on IT and its commitment to staying current with technology.

Legacy systems are characterized by obsolete software, such as hierarchical databases and structured programming languages, and character-based computer screens. Many of these technologies were developed in the 1960's and they have become expensive to develop and maintain in the 21st century. In many cases, original equipment and software vendors for these technologies are no longer in business or no longer provide enhancements and support to the systems. Many legacy systems are non-compatible with modern systems and require significant development time and experience to interface for the purposes of knowledge management, et cetera.

Modern or fourth-generation computer technologies are characterized by relational databases, graphical user interfaces, and object-oriented programming languages. These systems are generally easier to development and maintain because vendors supply regular enhancements and the talent pool is larger, driving down development costs.

As noted by Croxford et al. (2005): "Given that it is legacy systems that are inhibiting the banks' progress in many ways, and absorbing huge costs in doing so, then the IT industry has to choose between optimizing/improving the status quo or doing something differently" (p. 115). CCS, for example, has a very large, in-house development group to just maintain the core banking system. It is highly customized and CCS has not stayed current with vendor product releases. CCS' other major systems, including insurance, wealth management, and CRM, are all

supplied from different vendors but are built on identical, Microsoft technologies. The incompatibility of the core banking system with other modern systems makes interfacing the systems difficult and costly.

Vancity has created its own IT subsidiary Inventure Solutions, Inc. Inventure provides solutions to several clients, including Vancity and its Internet-only bank. Legacy systems will also be an inhibitor for Vancity to become a technology innovator.

Custom, in-house development has advantages in allowing banks and credit unions the ability to provide unique products and services to their customers. However, enhancing legacy systems is expensive and the return on investment for new products becomes hard to justify.

Envision, Prospera and Westminster operate almost identical, core banking systems from the same vendor, Open Solutions, Inc. These credit unions reap the benefit of receiving timely software upgrades from the vendor and reducing the cost of having an in-house, software development teams. The disadvantage, however, is not being able to customize or enhance the system in a timely manner to provide new and unique products or react to a competitor's new product.

All of the credit union rivals spend approximately the same percentage of their operating expenses on computer hardware and software. Other expenses, such as IT salaries, consultants, and telecommunications, were not itemized in most annual reports. RBC appears to spend almost three times that of credit unions on technology. This is not surprising considering the global scope of its IT operations. (RBC has 60,000 employees in 21 countries).

According to Croxford et al. (2005, p. 108), IT equipment for banks is approximately 20 percent of the overall IT expenditures. Internal IT staff or outsourcers expenditures are 35 percent, consultants and contractors 20 percent, telecommunications 10 percent, systems software

five percent, banking applications five percent and other applications five percent. These ratios appear reasonable and they have been applied to CCS' operating expenses in an attempt to identify non-itemized IT costs.

CCS is the only credit union to delineate an operating expense labelled "technology." In 2005, this expense was $18.3 million. If we assume that this represents all areas of IT spending, and we apply Croxford's 20 percent allocation to equipment, we get $3.7 million. This is very close to the $3.9 million that CCS actually spent in 2005.

Applying the 35 percent for internal IT staff expenditures to the total technology figures, results in a cost of $6.4 million for salaries and employees benefits. CCS has approximately 2,000 employees of which about 110 are IT or 5.5 percent. Total employee salaries and benefits for 2005 were $104 million. Applying 5.5 percent to company's total we arrive at $5.7 million. Although not an exact match to the $6.4 million result from Croxford's model, the difference in these rough estimates can be attributed to the higher salaries generally paid IT professionals.

As the cost of IT increases, credit unions are seeking alliances to reduce costs. Envision's Pathway Project, for example, is an inter-provincial partnership with First Calgary Savings to integrate banking systems onto a common technology platform.[42] They seek additional credit unions and affiliates to join the project. This partnership is possible because both credit unions operate systems from the same vendor.

As discussed in Section 1.4.1.1, transaction growth in online banking has increased 500 percent between 2000 and 2005.[43] All five rival credit unions have online banking systems provided from Credit Union Central of BC. Although each credit union can customize the look and feel of their websites, the core, online banking functionality available on their websites is the

[42] Envision Credit Union, *2005 Annual Report*, p. 16.
[43] CBA. Retrieved June 7, 2007, from http://www.cba.ca/en/content/stats/delivery%20channels%202005_eng.pdf.

same for each member credit union. Credit unions enjoy economies of scale gained through a common service provider, but lose the ability to develop first-mover, Internet advantages for their online customers.

As more customers rely on the Internet for performing banking functions, it is critical for banks and credit unions, and their Internet service providers, to provide consistent, reliable and secure access to their websites. Gomez.com monitors and benchmarks the speed and reliability of the online banking websites of the financial institutions in the US and Canada. Appendix 9, Canadian bank Web performance benchmarks, contains the May, 2007, results from Gomez.com on three important performance benchmarks for online banking websites: response time, availability and consistency. The results indicate that CCS and Vancity rank consistently high in their performance against some of Canada's major banks, including RBC.

## 2.10 Strategic alternatives

Strategic alternatives are derived from key success factors in the industry and the competitive analysis. There are two strategic alternatives available to CCS: a merger with Vancity and enhance technology.

### 2.10.1 Alternative A – Mergers and acquisitions

This alternative is a stated objective of CCS' existing 10-year strategic plan. A merger or acquisition increases the size of a credit union. Evidence was presented in Section 2.1.1 which showed that large credit unions operated more efficiently than smaller ones and "provided substantial evidence to suggest the existence of economies of scale in the industry" (Kohers and Mullis, 1988, p. 1657). Larger credit unions are also able to increase business with existing members creating a positive correlation between size and financial performance. The larger financial institutions, like RBC, rank extremely high against competitors in their return on assets, return on equity and productivity expense ratio. (See Table 2-9).

### 2.10.2 Alternative B - Enhance technology

This alternative is a strategy whereby CCS upgrades or replaces its legacy technology to bring it to the level of their competitors and creates technology platforms to respond rapidly to innovations in the marketplace. Information technology is at the heart of transaction processing for banks and credit unions. The cost of legacy technologies can affect efficiencies and economies of scale. The deployment and use of technology by staff can have an impact on productivity and customer interactions. Allen and Liu (2005) found that "banks that adopt newer technologies are likely to be more cost-effective than using older technologies" (p. 82). New entrants and substitutes into the financial service marketplace are often niche firms leveraging technical advantages against incumbents.

# 3 Internal Analysis: Organic Growth and Legacy Technology

The internal analysis includes an examination of management preferences, the organization, and resources. Management preferences are compared to the preferences required to achieve the strategic alternatives. The key organizational capabilities, including structure, processes and culture, are examined for gaps required to implement the strategic proposals. Finally, the marketing, operations, financial and human resources are compared to the resources required for the implementation and success of the alternatives.

## 3.1 Management preferences

Management preferences at CCS are focused on the company's 10-year strategic plan. This includes organic growth, merger and acquisition activities, and expansion into ten provinces. The Senior Executive Team (SET) consists of nine individuals with extensive experience in the financial services sector in Canada and three having MBA degrees. Management articulated their support for corporate strategy in CCS' *2005 Annual Report:*

> Coast Capital Savings is a long-time supporter of consolidation within the credit union industry. We see it as the most significant way for the industry to remain competitive in today's increasingly complex market. While we remain interested in combining our operations with other credit unions, our current focus is to expand the organization by growing our membership, opening more aperio stores in new communities, and introducing unique products and services. (p. 15)

The eleven-member Board of Directors determines the strategic direction of the credit union. According to CCS' *2005 Annual Report*, the Board of Directors "sets policy, approves operating and strategic plans, and is responsible for overseeing management operations and ensuring the credit union complies with regulatory and statutory requirements." (p. 22) Directors

are elected for a three-year term, with one third of the board being elected on an annual basis. The SET actively recommends candidates it feels will best serve in executing the strategic plan.

Alternative A, mergers and acquisitions, is integral to CCS's strategic plan. Management preferences favour this alternative and the management team that engineered the 2002 merger are in senior positions in the company today. The merger with Surrey Metro Savings was considered a merger of equals. In order to achieve its strategic targets in the next five years, CCS will have to find one or more suitable merger partners. The gap in management preferences lies in the difference between what was considered a suitable merger partner in 2002 and 2007. To close this gap, management must develop new criteria for selecting a merger partner. Management is a capable of finding a merger or acquisition target without hiring additional staff or consultants. The benefits of consolidation include increased efficiencies and economies of scale, as discussed previously in this paper.

The cost of the 2002 merger was $139 million; "$109 million for the shares of Surrey Metro Saving, and $30 million in merger expenses" (CCS, 2003, p. 13). A conservative estimate for the cost of a merger of equals, like Vancity, today would be about $500 million.

Alternative B, enhance technology, is not expressed in CCS' strategic plan. In 2004, CCS made the decision not to replace the legacy, core banking system with a modern system. Instead, they decided to upgrade the existing system, leaving the legacy database structure and application development system in place. Management preferences have been focused on delivering new products, like no-fee accounts, to customers using existing technologies, not replacing legacy systems.

The costs of upgrading the legacy system are estimated to be between $2-3 million over three years. The costs of a new, modern system have been estimated at between $5-10 million.

Internally, management is committed to the Distributed Network Model (DNM), as discussed in Section 1.4.1.1. The DNM means that all new and existing products and services will be delivered equally to all distribution channels, including the Internet. As CCS continues with its policy of disruptive differentiation, new products and services may be designed that cannot be delivered through certain channels because of limitations in technology associate with that channel.

There is gap between management preferences and Alternative B: management prefers to retain legacy systems instead of upgrading or replacing them to the level of the competition, or investing in technology that will allow it to respond quickly to innovations in the marketplace. This gap is accentuated by the fact that CCS is committed to multi-channel delivery of its products which requires an investment in newer technologies. Therefore, Alternate B requires modification to make it a more attractive proposal (Crossan et al., 2005, p. 133). Instead of replacing legacy systems as a strategy of technical equality against competitors, CCS can target specific technologies that will complement and enable their disruptive differentiation model.

### 3.1.1 Alternative B2 – Alliance with CommunityLend

An alliance with CommunityLend, the incubating, peer-to-peer (P2P) Internet lending company, is an alternative designed to fill the management preference gap and combat the threat of substitutes to CCS' competitiveness. (Refer to Section 2.2.2, above, for details of P2P lending). The nature of the alliance is designed to give CCS access to new technology, drive new membership growth, increase loan growth and attract Internet-savvy, networked, young adults that are part of the utility market to join the credit union. The incentive for CommunityLend is access to potentially 360,000 lenders.

This alternative fills the gap because it does not require CCS to replace any of its core legacy systems. This alternative allows CCS access to new technology, in the form of the online

auction business model without having to develop the technology itself. This alternative enhances CCS presence on the Internet, one of the primary delivery channels of the DNM. Finally, this alliance follows CCS' model of disruptive differentiation by being the first credit union in Canada to establish an alliance with a P2P lender.

#### 3.1.1.1 Structure of the alliance

CommunityLend's peer-to-peer lending would go through CCS. CommunityLend would license the technology to CCS and CCS would act as a hub for its members to access CommunityLend. How would it work?

From the borrowing perspective, CommunityLend would screen all of the borrowers for identity and credit risk, usually by downloading a copy of their credit report. They would then classify each borrower according to their credit risk and assign them to a risk category.[44] Each borrower would look at the loan offers made to him/her and accept them or not. "Loans are diversified across a good number of borrowers to mitigate the risk to any one person" (Freeman, 2006a, p. 17). In addition, CommunityLend would be responsible for all aspects of the lending process, including loan origination, payment processing, statement printing, late fee calculation, collections, et cetera.

From the lending perspective, a person would have to first become a member of CCS to access borrowers on CommunityLend. To do that, the person would have to deposit money into a share (savings) account. This is standard practice for joining any credit union. Second, the member would decide if they wanted to lend to borrowers on CommunityLend. If they did, they would stipulate the amount of each loan they would be willing to lend and the rates of return they would require for each loan amount. (A person may be willing to loan a small amount at high rate and a larger amount at a lower rate). Third, CommunityLend "would then tap into the money

[44] See http://www.prosper.com/help/topics/borrower-credit_grades.aspx for Prosper's credit rating system.

after it finds loans that would support the returns sought by the individual lenders. The credit union member ends up with a [term deposit] from the credit union at a favourable rate of return" (Freeman, 2006b, p. 17).

Other opportunities exist for CCS in its alliance with CommunityLend. For example, CCS could offer repayment protection insurance or other types of insurance to CommunityLend borrowers. CCS also has the opportunity to mediate like-minded groups of borrowers, such as small business owners and entrepreneurs, with like-minded lenders, similar to Vancity's Peer Lending Program.[45]

#### 3.1.1.2 Return on investment

Prosper, the US-based, P2P lending website, publishes marketplace performance statistics, including estimated return on investment, delinquency activity, et cetera, online. Rates of return are calculated for each credit grade. A credit grade is assigned to a borrower based on their credit score.

From June 21, 2006, through June 21, 2007, Prosper originated US $22 million dollars in loans with a net default rate of only 0.28 percent across all grades.[46] Table 3-1, below, displays the amount of loans originated, the average lender rate, and the average annual return for each credit grade for the one year period previously specified. The average annual return reflects deductions from the average lender rate for rate adjustments (interest and fees), net defaults, and Prosper servicing fees.

[45] See https://www.vancity.com/MyBusiness/BusinessFinancing/PeerLending.
[46] Source: www.prosper.com. Retrieved July 22, 2007, from http://www.prosper.com/lend/performance.aspx.

**Table 3-1: Market Performance Prosper.com**

| Credit Grade | Loan Amounts (USD) | Average Lender Rate % | Average Rate of Return % |
|---|---|---|---|
| AA | 5,165,393 | 10.17 | 9.09 |
| A | 4,331,177 | 12.10 | 10.18 |
| B | 4,664,652 | 14.24 | 10.74 |
| C | 3,905,759 | 16.85 | 11.57 |
| D | 2,756,672 | 19.6 | 11.08 |
| E | 853,396 | 22.72 | 8.34 |
| High Risk | 224,557 | N.A. | N.A. |
| No Credit | 10,100 | N.A. | N.A. |

*Source: Adopted and retrieved July 21, 2007, from http://www.prosper.com/lend/performance.aspx.*

How much in loans will CommunityLend be able to originate in its first year of operation? Calculations from Prosper's website (http://www.prosper.com/lend/performance.aspx) indicate that it originated approximately US $10 million in its first year of operation. The existence and popularity of both Zopa in the UK and Prosper in the US have been well publicized in North America, as well as the launch of CommunityLend in Canada (Greenwood, 2007).

If an alliance was established with CCS, it is conceivable for CommunityLend to originate $5 million in its first year. CCS could end up owning 20 percent or $1 million of those loans. (It also means CCS would issue $1 million in term deposits). Assuming an average rate of return of 10.5 percent on the loans and an average payout rate of 5.0 percent on term deposit, CCS could net $550,000 in the first year.

CCS would create a risk-adjusted spread to determine the rate of the term deposit. The spread could be higher than the "haggle-free" rate, creating the incentive for a credit union member to lend to a CommunityLend borrower. However, the rate would be below the interest

rate being paid on the loan. The difference would be the rate of return to CCS. This return would need to offset the risk of loans defaulting. The length of time of the term deposit may or may not be pegged to the term of the loan. CCS would need to construct financial models to determine the rates of the term deposits. CommunityLend would make its profit by taking a commission on each loan.

Although loan growth is one objective for the CCS' alliance with CommunityLend, the other is membership growth. CCS' free chequing account product attracted approximately 25,000 new members in its first year. The peer-to-peer lending alliance has the potential to attract 10,000 new members in its first year.

There are minimal costs associated with developing a strategy analysis aligned with the Alternative B2, alliance with CommunityLend. Current senior management is capable of drafting such a proposal. The benefit of this strategy is that CCS can incrementally improve their technology footprint as part of the DNM and increase both membership and loan growth.

## 3.2 The organization

Internal analysis of the organization includes its structure, management processes, culture and leadership behaviour. Each of these areas of the organization is examined as they relate to strategic Alternatives A and B2. The changes that are needed in these four areas to support the strategies are summarized in Section 3.2.5, below.

### 3.2.1 Functional structure

CCS is a functional organization that is structured to serve the various personal and business products and services offered to its membership base. Subsumed under the nine members of the Senior Executive Team are thirteen operating executives responsible for commercial real estate lending, finance, information technology, retail services, retail

performance, investment services, treasury, public affairs, commercial services, risk management, performance analytics, human resources, and insurance. The head office of CCS is located in Surrey which is part of the greater Vancouver area.

In addition to the three, wholly owned subsidiaries for insurance, mutual funds, and commercial leasing, CCS maintains a strategic relationship with Qtrade Investor to provide online brokerage services to its members. CCS does not have an ownership or joint venture position with Qtrade Investor.

The 49 branches and aperio stores have their own organizational structure consisting of branch managers, and customer, financial, and insurance representatives. Thirty-four branches are in the Vancouver area and 15 on Vancouver Island.

The functional organizational structure of the company has geographic components. The head office for the insurance subsidiary is located in the city of Victoria on Vancouver Island. The human resources division of CCS maintains a satellite office in Victoria to handle the employment of personnel on Vancouver Island.

The Information Technology Group (ITG) is a matrix organization consisting of a number of groups including project managers, business analysts, software developers, quality assurance people, database administrators, systems engineers and helpdesk personnel. A chief information officer, a vice president of the ITG, and seven middle managers provide leadership to the ITG.

### 3.2.2 Management processes

Each business unit is responsible for preparing short and long-term business plans that are presented to the Senior Executive Team (SET) for approval. The SET meets on a quarterly

basis to review and approve any new initiatives for the company, including business unit plans. The SET obtains approval on all strategic initiatives from the board of directors.

This process has had a very important impact the ITG. Prior to 2005, the ITG was responsible for collecting and prioritizing the IT requests from the various lines of business. IT projects were often prioritized and executed for the business unit that had the most political influence. This process also affected which business units received money for capital IT projects. This ad hoc decision making regarding IT investments left several business units running antiquated systems.

In 2005, the prioritization of IT projects was pushed to the level of the SET. This has been beneficial to CCS because IT projects are now aligned with business initiatives, such as haggle-free products. This has allowed the ITG to focus on improving processes and procedures to implement IT projects in a timely and accurate fashion. The SET quarterly review and approval process has allowed CCS to increase the flow of new products to the market and create synergies between business units.

New product development has been a key to CCS' organic growth strategy. Much of the product innovation is driven from the finance department's risk management capabilities, the marketing department's close relationship with its customers, and the SET's keen awareness and monitoring of competitive forces in the financial institution marketplace.

CCS seeks alliances with strategic partners that can enhance their brand image in the community, particularly in the retail outlets. CCS' *Big Perks for Small Business*™ campaign was tied to an agreement with FedEx Kinko's Office and Print Centres that offered significant discounts on products and services to small business owners. The agreement also saw the placement of FedEx mailboxes in selected branches.

### 3.2.3 Culture based on cooperation and social responsibility

The management, board of directors, and employees of CCS are committed to the vision, mission, values and 10-year strategic plan. The vision is to grow and remain "a relevant and innovative financial services provider in Canada." The mission is to provide "easy-to-understand solutions to our members' complex financial situations" (CCS, 2005, p. 1). The values of the organization are encapsulated in the cooperative nature of the credit union philosophy: customer centricity, corporate citizenship, and company spirit.

CCS maintains a high commitment to corporate social responsibility. This is an integral part of the culture at CCS. It seeks to demonstrate this commitment in seven areas: transparency and accountability, ethical business practices, community support, progressive employee development, democratic governance, environmental awareness, and healthy financial outcomes (CCS, 2005, p. 1). Many of these ideals are contained in the cooperative principles of the credit union movement. (See Appendix 7 - Cooperative Principles of Credit Unions).

In 2005, CCS contributed $3.8 million to community causes. These contributions included everything from support to a variety of non-profit organizations, to sponsorships, community loans, and staff volunteerism. CCS grants employees one day of paid leave each year to volunteer at a charitable organization or activity of their choice.

### 3.2.4 Leadership behaviour: a regulatory worldview

The leadership of CCS operates in the context of what Wexler (2005) refers to as a regulatory worldview. This worldview is characterized by uncertainty reduction and emphasizes prudence, stability, loyalty and position over person. CCS operates in a highly regulated market governed by a hierarchical rule-based system. Organizations with a regulatory worldview are managed through bureaucratic leadership.

Bureaucratic leadership is characterized by fact gathering, planning, minimizing errors and maintaining stability. Credit union members place trust in the organization's ability to protect their money, grow their assets, and minimize their risk. Therefore, bureaucratic leadership "invests heavily in fortifying and protecting the core routines of the system" (Wexler, 2005, p. 85).

Part of this protection is manifest in the technology employed by CCS. The regulatory worldview of technology is one of reducing uncertainty by routinizing and standardizing procedures. "Technology is adopted when it can be integrated into an ongoing system without too much disruption" (Wexler, 2005, p. 143). This author's experience as a manager in the ITG at CCS supports this worldview: Technology is not seen as a platform for innovation or a tool to create a competitive advantage. It only plays a supporting role to the delivery of new products and services.

Although the internal leadership behaviour is bureaucratic, to the outside world CCS is seen as an organization operating from a network worldview. This worldview is characterized by change and innovation, stimulation and challenge, intellectual capital, and boundarylessness (Wexler, 2005, p. 13). It could be argued that this is supported by CCS' new product offerings, new aperio stores, and push to expand extra-provincially. However, Wexler (2005) would argue that this is all part of being an effective planner and that CCS' strategy is designed to "deal with emergent possibilities" (Wexler, 2005, p. 131). From this context, the role of a bureaucratic leader is to be vigilant, proactive, and maintain sufficient reliable knowledge for effective planning. This characterizes CCS' leadership style and those of most financial service providers.

### 3.2.5 Summary

All four aspects of the organization are ideally positioned to implement Alternative A, mergers and acquisitions. The structure of CCS mirrors the structure of other credit unions in the

province. Any merger requires the approval of the board of directors of each organization. In addition, a merger requires the voting approval of members of each credit union. (See Section 2.6.2 regarding FICOM rules). The management and board of directors of CCS have experience in the processes necessary to execute a merger. The cultures of other credit unions reflect the cooperative principles and philosophy of the industry and the leadership behaviours of other organizations reflect a regulatory worldview. No gaps are perceived in the organizational capabilities to accomplish Alternative A.

Alternative B2, an alliance with CommunityLend, does not require any changes to the structure of the organization nor management processes. In addition to the Information Technology Group (ITG), CCS has a business unit responsible for the non-technical aspects of the company's Internet services and the relationship with Credit Union Central of BC who host CCS's online banking system. This business unit would be responsible for the day-to-day, operational relationship with CommunityLend.

CCS has a strategic planning business unit that handles the initial administrative and legal aspects of establishing strategic relationships. This business unit was responsible to creating the FedEx Kinko's relationship as part of the *Big Perks for Small Business*™ program and is capable of structuring an agreement with CommunityLend as part of Alternative B2.

At the senior management level, the processes are in place to review, approve and execute an alliance with CommunityLend. From the perspective of the ITG, the processes currently in place to implement IT projects are sufficient to deliver on the requirements of Alternative B2.

## 3.3 Organizational resources

Four resource categories are examined to determine if they are capable if implementing the strategic alternatives. The four resource categories examined are marketing, operations, human and financial. Each subsection examines the resource-strategy linkage with Alternatives A and B2.

### 3.3.1 Marketing resources

CCS has a very talented and innovative marketing department as evidenced by being awarded "Marketer of the Year" in 2006 by the British Columbia Chapter of the American Marketing Association. This award was granted for CCS' effective branding strategy and inventive product offerings that included the "Free Chequing, Free Debit and More Account™," the "Haggle-free Guarantee™," and the new aperio stores.

All of CCS' advertising reinforces the brand with the corporate motto "How Can We Help You?" The motto is used in all of CCS' forms of advertising including television, print, radio, websites, and telephone calls to Contact Centre employees.

The challenges surrounding Alternative A relate to the branding of a merged entity. CCS became a new brand in 2000 with the merger of Richmond Savings and Pacific Coast Savings. However, when CCS merged with Surrey Metro Savings in 2002, the merged entity retained the CCS brand. In a merger with Vancity, for example, a similar decision would have to be made. Assuming a new brand was not created, and the CCS brand was chosen over Vancity, it could cost as much as $10 million alone to rebrand the 52 branches of Vancity, or about $200,000 per branch, with CCS signage.

Although CCS has currently sufficient marketing resources, a merger with a large credit union, like Vancity, would require an increase in marketing expenses. Marketing expenses would

have to increase to advertise the new merger to the members and general public. CCS marketing expenditures were $6.6 million in 2005. In the same year, Vancity spent $14.4 million on advertising and promotion. A merged entity would probably see at least a 25 percent increase in Vancity's current expenditures. This gap would have to be filled through the efficiencies and economies of scale achieved by being a larger organization.

CCS has the marketing resources to advertise and promote Alternative B2, the alliance with CommunityLend. The costs for CCS will be similar to those of other major promotional campaigns, such as the "Free Chequing, Free Debit and More Account™" or the *Big Perks for Small Business*™ program. The author was unable to determine the exact advertising costs of these initiatives, but they are estimated to be in the range of $1-2 million each.

CCS has experience and success in advertising its alliances with other partners, like FedEx Kinko's. Maximum impact and benefits from Alternative B2 can be achieved if CCS and CommunityLend coordinate their advertising and promotional efforts. CCS has been very successful using traditional media to advertise its products and services, as mentioned earlier. Although CommunityLend is a virtual organization, it will also have to use traditional media to create brand awareness and attract borrowers and lenders to its website.

Although CommunityLend is not a traditional financial institution, its motto, "Where People Lend to People," reflects the cooperative principles of credit unions. This motto can be leveraged to the benefit of both parties.

### 3.3.2 Operations resources

CCS' main lines of business are personal and business banking services. These products and services include savings and chequing accounts, term deposits, mutual funds, mortgages, loans, lines of credit, credit cards, foreign currency, automated bank machines, et cetera. CCS

also provides insurance, investment, and commercial leasing services through three wholly owned subsidiaries. There are three main distribution points for CCS' products and services: brick-and-mortar branches, the company's website, and the telephone Contact Centre.

CCS' corporate head office is located in Surrey, BC. It houses the Senior Executive Team, and many of the specific operational units including marketing, commercial real estate lending, finance, retail services, retail performance, treasury, public affairs, commercial services, risk management, performance analytics, and human resources. In addition, CCS leases four floors in the Central City building in Surrey, BC, to house its investment services division, telephone Contact Centre, its training department (Coast University), and sections of its retail services and information technology departments.

CCS maintains an administrative office in Victoria to manage operations on Vancouver Island, including its 34 branches there. The administrative office in Victoria is the headquarters for the insurance subsidiary and the Information Technology Group is headquartered in one of the branch buildings.

CCS' most important operational alliance is with Credit Union Central of British Columbia (CUCBC). CUCBC provides core financial services, development services, technology solutions, and other trade association benefits to CCS. CUCBC' online banking and Internet solutions for consumer and business customers are of particular importance to CCS.

The Information Technology Group (ITG) is responsible for the information technology needs of the organization. This includes, among other things, designing the enterprise architecture, purchasing and installing computer hardware and software, and executing IT projects in support of the company's strategic plan. The ITG supports three major software systems: the core banking system, the insurance policy system, and the wealth management or mutual fund system. Each of these computer systems was developed by separate vendors either

in Canada or the United States. The ITG purchases ongoing maintenance and support agreements with each software vendor. These agreements usually include regular software upgrades, 24-hour technical support, et cetera.

Alternative A, mergers and acquisitions, would require the management teams of the merging organizations to plan the integration of operations resources. In the case of a merger between CCS and Vancity, both management teams are capable of planning a successful integration. It would require a minimum of one-to-two years to plan the integration prior to the merger. This would include all subsidiaries as well, like insurance and investments. If CCS merged with a credit union that had never been through a merger, CCS would have to provide the resources necessary to fill the gap in the lack of integration expertise in the new partner.

A merger or acquisition would have a significant impact on the organizational resources of both credit unions as many operations resources end up being duplicated. In the case of merger, there may be a power struggle among upper management if a new organizational structure, and lines of authority and decision making, are not defined in the merger agreement. In the case of an acquisition, the impact on both organizations can be decided in advance of the consolidation date. Eliminating the duplication of resources is part of Alternative A.

Alternative B2 would impact operations in a similar manner to the research, development and implementation of the "Free Chequing, Free Debit and More Account™" product. The finance department at CCS would construct financial models to determine their risk exposure to various categories of CommunityLend loans and the rates for term deposits based on the spreads. Additionally, the finance department would be responsible for ongoing, statistical analysis of their participation in the CommunityLend loan portfolios. This would include modifying interest rate profile models, and the like. The finance department is capable of constructing the necessary financial models and monitoring the loan portfolios for this alternative.

Approximately 50 percent of the operations resources required for this alliance are IT related. From a technical point of view, all of the data regarding the borrower would be stored in a CommunityLend database, presumably in the Toronto area. Through the license agreement with CommunityLend, CCS would create an interface into the lender portion of the CommunityLend system that would pass information about CCS lenders, i.e. the loan amounts and rates of return, into the CommunityLend system so that is available for analysis by the borrowers.

This exchange of data requires that two computer gateways or interfaces be constructed. One interface would allow CCS to upload lender information into the CommunityLend system. The second interface would allow CCS to download information about the loans that had been acquired by CommunityLend borrowers from CCS members. A communication protocol would have to be developed to facilitate data transfer between the two systems. Both companies have the necessary technical expertise to build the necessary gateways and communication protocol, and perform the transfer and analysis of data.

### 3.3.3 Human resources

The human resources department of CCS is responsible for approximately 2,000 employees working in the Lower Mainland and on Vancouver Island. None of the staff is unionized, including the staff in the three subsidiaries. The voluntary employee turnover rate in 2005 was 10.1 percent and the employee satisfaction rate was 74.8 percent.[47] By contrast, the employee turnover was seven percent and employee satisfaction was 91 percent for the 2,340 employees at Vancity in the same year.[48]

[47] CCS employee turnover rates were 8.2 percent, 10.6 percent, and 10.1 percent for 2003, 2004, and 2005, respectively.
[48] Vancity, *2005 Annual Report.*

There is considerable internal transfer of staff within and between branches as personnel upgrade their skills from customer service representatives, to financial service representatives, insurance representatives, telephone Contact Centre personnel, branch managers, and the like. CCS has a tradition of nurturing career development and promoting from within the organization. With 52 credit unions and at six chartered banks in BC, many with branches in the same geographic markets as CCS, the competition for hiring this talent is significant.

CCS has sufficient human resources to accomplish Alternative A, a merger or acquisition. The greatest impact on CCS employees resulting from a merger depends upon whether or not CCS is the acquirer or the acquired. In the 2002 merger with Surrey Metro Savings (SMS), CCS was in the acquiring position and loss of jobs, due to redundancies, fell more heavily on SMS employees.

A merger or acquisition always results in employee turnover because not all employees are happy with the management and operations of the newly formed organization. IT departments, in particular, are often downsized within one year after a merger because the merged entity does not operate duplicate computer systems and the staff that support them. Both IT departments are required in the first year of a merger to successfully convert the data from one system to the next. However, once the systems have merged, the staff supporting the obsolete system is not longer needed.

Alternative B2, an alliance with CommunityLend, will require access to resources in a number of areas of the organization. In the case of this alliance, a full-time person from the office of strategic planning would conduct the research and draft the business the plan with input from the finance, marketing, and IT departments. This resource currently exists and was responsible from drafting the business plan for the aperio store initiative. Part-time resources would be

required from finance, marketing, and IT to provide input into the business plan and those resources also exist.

Development and execution of a marketing plan would require the part-time contributions of the existing marketing staff. Marketing campaigns are developed with a team of individuals and CCS often contracts with outside marketing firms, particularly for the development of television commercials and radio advertising. CCS would have to work with CommunityLend to decide on the nature and scope of any advertising.

If CCS was allowed to advertise other products and services on the CommunityLend website or directly to borrowers, CCS has sufficient marketing resources to accomplish those tasks.

The Information Technology Group (ITG) at CCS has approximately 115 employees or about six percent of company's employees. Approximately 35 ITG employees are located on Vancouver Island and the remaining 80 employees are located in Surrey. The ITG has expertise in all areas of IT required to support the existing systems and deliver the current suite of new products and services. Expertise exists in the areas of project management, business analysis, software development, quality assurance, database administration, systems installation, and overall technical support for computer-related infrastructures, including the digital telephone system.

The ITG has the proper resources to design and build the software interfaces necessary to exchange data with CommunityLend's computer systems. This project would take approximately nine months to implement. The ITG resources required include one part-time project manager for the duration of the project; one fulltime business analyst in the two months; two fulltime software developers for six months; one database administrator for three months; and one quality assurance person for three months. CommunityLend would need to supply the services of one

software developer on a part-time basis for the duration of the project and one full-time business analyst to work with CCS' business analyst at the beginning of the project.

### 3.3.4 Financial resources

Section 2.9.2 of this paper contains a detailed financial analysis of CCS and five major competitors. CCS ranked second it that analysis. CCS has demonstrated strong financial performance, increasing net interest income by $92 million between 2001 and 2005, and assets by $5.0 billion in the same period. Retained earnings for CCS in 2005 were $275 million. Retained earnings have increased 64 percent from 2001 through 2005 while non-interest expenses increased only 58 percent in the same five-year period to $185 million.

CCS can expect to increase occupancy and equipment expenditures as it continues to expand its aperio store model with new branch construction and remodelling of existing branches. Three aperio stores were opened in 2005 and two in 2006. Capital expenditures in 2005 increased to $16.3 million, compared to $6.9 million in 2004 (CCS, 2005, p. 32). Expenditures on computer equipment and software increased 30 percent between 2001 and 2005 to $6,366 million.

A simple consolidation or merger of equals, under Alternative A, would require little or no financing. Each voting or equity share would be exchanged on par for shares in the combined entity. Non-voting shares can be purchased through a combination of retained earnings, subordinated notes, or an increase in borrowings.

There is the risk in a merger that significant portions of members from both credit unions did not want to merge and choose to redeem their shares. This risk is low since any merger requires voting approval by the members of both entities.

The cost of CCS' 2002 merger was $139 million; "$109 million for the shares of Surrey Metro Saving (SMS), and $30 million in merger expenses" (CCS, 2003, p. 13). At the time of the merger, each credit union had approximately $3 billion in assets. Although labelled a merger,

> ...CCS acquired all of the assets and assumed all of the liabilities of SMS. The business combination was funded by way of a private placement of subordinated notes of $50.0 million and an increase of borrowings of $58.6 million. The holders of SMS non-voting shares received $21 per share and the [voting] shares held by SMS members were exchanged [on par] for shares of CCS.[49]

CCS is in a financial position to acquire any credit union in BC, with the exception of Vancity. Envision, the third largest credit union in the province, has $2.4 billion in assets, slightly smaller than SMS at the time of the 2002 merger. Envision has $15 million worth of non-voting equity shares.[50] The number and market valuation of those shares is not known. None the less, CCS is in a strong financial position to assume the assets and liabilities of a credit union the size of Envision.

*CCS is not in a financial position to acquire Vancity.* A merger with them would have to be an exchange of equity shares. A review of Vancity's 2005 and 2006 annual reports does not indicate the existence of non-voting shares.

The total cost for Alternative B2 for CCS is estimated to be approximately $1 million with advertising being the biggest, single variable. Planning and implementation is estimated at $500,000 and advertising is the same.

Planning and implementation is divided as follows: $50,000 for research and planning; $25,000 for legal and administrative expenses; $30,000 for business analysis; $25,000 for project management; $50,000 for computer hardware; $80,000 for software development; $40,000 for database design; and $40,000 for testing. An initial, annual licensing fee for access to

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[49] CCS, 2002, p. 16.
[50] Envision Credit Union, *2005 Annual Report*, p. 42.

CommunityLend technology is estimated at $50,000. Approximately $110,000 is held in reserve for potential cost overruns related to project delays, changes in computer hardware costs, or underestimation of licensing fees.

The cost of advertising is dependent upon the overall nature of the agreement CCS forges with CommunityLend. If CCS and CommunityLend chose to advertise their alliance, the costs would include the initial launch of the alliance, ongoing advertising to maintain customer awareness, and any advertising that CCS may be able to place on the CommunityLend website, such as advertising its insurance products. Therefore, estimated advertising costs for CCS could be as high as $500,000 for the first year, including the initial launch the alliance, maintaining customer awareness through advertising in various media, and advertising on CommunityLend's website.

# 4 Conclusions and Recommendations

CCS' core strength has been its ability to grow organically through innovative products and services. In the first five years of its 10-year strategic plan, CCS has not found a suitable merger partner. CCS achieved economies of scale solely through organic growth, and differentiated itself through its pricing model and unique, aperio branches. Although CCS does not appear willing to upgrade its legacy, core computer systems, it can gain implement strategies of technical innovation to foster continued disruptive differentiation.

The strategic alternatives proposed in this paper are mutually exclusive and both are supported as a result of this analysis.

## 4.1 Alternative A – Mergers and acquisitions

It is recommended that CCS pursue its strategic plan of mergers and acquisitions. It is only through consolidation that CCS will be able to achieve the growth targets it has specified in its strategic plan. Selecting an appropriate merger partner involves evaluating a number of factors, including the partner's size, location, personnel, cultural fit, financial condition, and proclivity towards consolidation. CCS will have to evaluate all of those factors as part of its merger due diligence.

CCS' merger with Surrey Metro Savings in 2002 was a merger of equals. An equivalent partner in 2007 is Vancity. CCS is not in a financial position to acquire Vancity, but an exchange of voting shares is an option. If consolidation with Vancity were not possible, then CCS would have to change its selection criteria if it wishes to find a suitable consolidation partner in the next five years.

## 4.2 Alternative B2 – Alliance with CommunityLend

It is recommended that CCS pursue an alliance with CommunityLend. This will allow CCS to incrementally improve its technology and foster organic growth through disruptive differentiation. It is estimated that the alliance will cost CCS between $500,000 and $1 million in the first year, depending upon advertising expenses. Net interest income in the first year is estimated at $550,000. The alliance is estimated to attract 10,000 new members to CCS in the first year, especially from the utility market. Based on the success of Zopa and Prosper, the alliance with CommunityLend has the potential to be profitable for CCS in two years.

The biggest gap in internal capabilities for the success of this alternative is the vision of management regarding technology. The Senior Executive Team (SET), and in particular the chief information officer (CIO), must shift their thinking regarding the role technology plays at CCS. Instead of simply modifying legacy systems to deliver on new products, like free chequing accounts, the CIO needs to research and propose new technologies that form the core of new initiatives. Concomitantly, the CIO must bring forward to SET new technologies that can be differentiators for CCS. This means looking outside the organization to the technologies of competitors, and in particular, Internet-based substitutes and the chartered banks.

Technology is a key success factor in the financial services industry, yet it is not a part of CCS' 10-year strategic plan, in spite of the emphasis placed internally on the Distributed Network Model in 2004. In the short-term, because of the banking system upgrade, CCS management will not have sufficient time to shift its thinking regarding its strategy on technology to make it a key component of the existing plan. However, technology can immediately be included as an important component of new value propositions and the quarterly, planning and decision-making meetings of the SET.

The IT management team, beginning with the CIO, need to become technology crusaders or evangelizers within the organization. This requires changing people's mindsets regarding the importance of technology in maintaining a competitive advantage in the retail banking marketplace. A successful product, like the free chequing account, which uses legacy technology, can mask the need for technical innovation. The IT management team needs to educate senior management on the fact that the next new product or service requests may not be able to be delivered with existing systems.

# Appendices

## Appendix 1 – Fourth Quarter 2005 Provincial Credit Union Results

| Provincial Credit Union Centrals | Total Savings/Deposits ($mils) | Total Loans ($mils) | Total Assets ($mils) | Total Credit Unions | Total Locations | Total Members |
|---|---|---|---|---|---|---|
| British Columbia | 32,121 | 29,737 | 36,026 | 52 | 352 | 1,538,501 |
| Alberta | 9,873 | 9,075 | 10,918 | 53 | 208 | 591,616 |
| Saskatchewan | 8,363 | 7,240 | 9,403 | 100 | 330 | 526540 |
| Manitoba | 9,268 | 8,519 | 10,170 | 57 | 177 | 514,179 |
| Ontario | 14,519 | 13,619 | 16,335 | 172 | 524 | 1,226303 |
| New Brunswick | 831 | 653 | 890 | 23 | 44 | 123,219 |
| Nova Scotia | 1,276 | 1,019 | 1,389 | 34 | 83 | 169,479 |
| Prince Edward Island | 564 | 458 | 613 | 10 | 15 | 63,261 |
| Newfoundland & Labrador | 506 | 434 | 538 | 14 | 43 | 43,495 |
| L'Alliance – Ontario | 720 | 638 | 806 | 13 | 26 | 67,977 |
| **Total** | 78,040 | 71,392 | 87,088 | 528 | 1,802 | 4,864,570 |

*Source: Adopted from Credit Union Central of Canada, 2006 Annual Report. Toronto, ON, p. 19.*

## Appendix 2 – Size of Financial Institutions in Canada

The following table lists the top ten financial services institutions in Canada by asset size on a consolidated basis in 2003.

| Company | Total Assets ($ millions) |
|---|---|
| RBC Financial Group | 403,185 |
| Scotiabank | 285,892 |
| Canadian Imperial Bank of Commerce | 277,147 |
| TD Bank Financial Group | 273,532 |
| BMO Financial Group | 256,494 |
| Sun Life Financial Inc. | 163,295 |
| Manulife Financial Corporation (not including Hancock) | 148,980 |
| Great-West Lifeco Inc. | 115,609 |
| Mouvement des caisses Desjardins | 94,652 |
| National Bank of Canada | 82,493 |

*Source: The Canadian Financial Services Sector, Annex. Department of Finance, Canada. Retrieved July 22, 2007, from http://www.fin.gc.ca/toce/2005/fact-cfsse.html.*

# Appendix 3 – History of Mergers for British Columbia Credit Unions

The following credit union mergers have occurred in the British Columbia system since 1990. Bold type indicates the continuing credit union name. As of December 31, 2005 there were 52 credit unions in British Columbia.

| **Mergers by year** |
|---|
| **2007** |
| Vantel Safeway and **Vancity** - April 1 |
| **2006** |
| Castlegar Savings name changed to **Heritage** - October 1<br>Terrace & District and **Northern Savings Credit Union**- July 1 |
| **2005** |
| Squamish Credit Union and **Vancity** - December 31<br>Village Credit Union and **Vancity** - July 4<br>North Country Credit Union name changed to **Integris** - April 20<br>Comox Valley, Evergreen Savings and **Coastal Community** - January 1 |
| **2004** |
| Lake Cowichan & District and **Island Savings** - December 31<br>Chemainus and **Coastal Community** - July 31<br>Nechako Valley, Quesnel & District, and **Prince George Savings** - June 1<br>*(Interim name **North Country Credit Union**)*<br>United Savings and Gulf & **Fraser Fishermen's** - May 1 |
| **2003** |
| Pacific Paper Industry and **Van Tel/Safeway Credit Union** - June 2<br>Stanovan Credit Union and **North Shore Credit Union** - May 31 |
| **2002** |
| United Savings Credit Union and **Allied Savings** - August 1<br>*(Name changed to **United Savings Credit Union**)*<br>Surrey Metro Savings and **Coast Capital Savings** - June 28<br>Van Tel and **Vancouver Safeway Employees** - January 1<br>*(Interim name **Van Tel Safeway Credit Union**)*<br>Thompson Valley and **Interior Savings** - January 1<br>*(Name changed to **Interior Savings Credit Union**)* |

| **Mergers by year** |
|---|
| **2001** |
| K.C.P. and **Valley First** - December 31 |
| Armstrong Spallumcheen Savings and **Valley First** - July 1 |
| Burnaby Savings and **United Civic Savings** - July 1<br>*(Name changed to **United Savings Credit Union** - July 2002* |
| Edelweiss and **Fraser Valley** - May 1<br>*(Name changed to **Prospera Credit Union**, May 2002)* |
| Delta and **First Heritage** - January 1<br>*(Name changed to **Envision Credit Union**)* |
| **2000** |
| Matsqui and **Aldergrove** - June 1 |
| Parksville & District and **Nanaimo** - July 1<br>*(Name changed to Coastal Community Credit Union)* |
| Pacific Coast Savings and **Richmond Savings** - December 31<br>*(Name changed to **Coast Capital Savings**)* |
| Okanagan Savings and **Thompson Valley** - December 31\ |
| **1999** |
| Alert Bay and **Evergreen Savings** - October 31 |
| C.N.R.E. and **Allied Savings** - September 30 |
| Edgewater District and **Kootenay Savings** - July 1 |
| Finning Employees and **Allied Savings** - April 30 |
| Houston and District and **Bulkley Valley** - November 30 |
| Lakes District and **Bulkley Valley** - September 30 |
| Polish and **Greater Vancouver Community** - May |
| Rossland and **Nelson & District** - May 31 |
| Sointula and **Evergreen Savings** - June 30 |
| Sound Savings and **Community Savings** - June 30 |
| **1998** |
| Alpine and **Greater Vancouver Community** - July 1 |
| B.C. Projectionists and **Greater Vancouver Community** - Sept. 30 |
| BCSR and **Greater Vancouver Community** - May 13 |
| Bella Coola Valley and **Williams Lake & District** - September 30 |
| Cee Pee and **Greater Victoria Savings** - June 30 |
| Elco and Gulf and **Fraser Fishermen's** - May 1 |
| Kimberley and **Kootenay Savings** - October 1 |
| Nicola Valley and **Thompson Valley Savings** - July 1 |
| Pacific Press and **Scott Paper Employees** - June 1<br>*(Name changed to **Pacific Paper Industry**)* |
| Snow Valley and **First Heritage Savings** - September 1 |

| **Mergers by year** |
|---|
| **1997** |
| Maple Ridge Community and **Westminster Savings** - December 1 |
| Teachers Savings and **Vancouver City Savings** - October **7** |
| VLC and Utilco - March 1<br>*(Name changed to **Sound Savings** - October 30)* |
| Warfield and **Kootenay Savings** - July |
| **1996** |
| No mergers |
| **1995** |
| Victoria Federal Employees and **Greater Victoria Savings** - June 30 |
| **1994** |
| Dairy Industry and **Pioneer**- November 1<br>*(Name changed to **Burnaby Savings**)* |
| Dogwood and **Westminster Savings** - June 1<br>*(Dogwood's Kamloops branch was acquired by **Nicola Valley & District**)* |
| **1993** |
| E.P. and Transport - June<br>*(Name changed to **Allied Savings** - July 4)* |
| Mt. Pleasant and **United Civic Savings** - June 1 |
| South Vancouver & District and **Vancouver City Savings** - May 1 |
| **1992** |
| C.P. Telecom Employees and **Transport** - August 7 |
| Civic Employees and **United Services** - January 1<br>*(Name changed to **United Civic Savings**)* |
| **1991** |
| Black Creek and **Evergreen Savings**, December 31 |
| Texada and **Powell River** - December 31 |
| Victel and **Pacific Coast Savings** - July 1 |
| **1990** |
| N.W.C.E. and **Civic** - April 1 |
| Pender Harbour and **Sunshine Coast** - September 15 |

*Source: Credit Union Central of British Columbia (CUCBC). Retrieved June 6, 2007, from http://infocentre.cucbc.com/_html/bc_mergers.html.*

# Appendix 4 – Market Share Increase for Foreign Banks

The following table summarizes changes in market share in the financial services sector. As indicated, market share increases for foreign banks have outpaced that of other financial institutions.

| Type of Institution | Net interest income | | | Non-interest Income | | | Value of services produced | | |
|---|---|---|---|---|---|---|---|---|---|
| | Market Share | | Change | Market Share | | Change | Market Share | | Change |
| | 1997 | 2004 | 1997 to 2004 | 1997 | 2004 | 1997 to 2004 | 1997 | 2004 | 1997 to 2004 |
| | % | | | | | | | | |
| **Domestic banks and all trust companies** | 79.6 | 76.5 | -3.1 | 86.1 | 84.0 | -2.1 | 82.4 | 80.0 | -2.4 |
| **Credit unions and caisses populaires** | 15.3 | 16.8 | 1.5 | 7.3 | 6.8 | -0.5 | 11.9 | 12.1 | 0.3 |
| **Foreign bank subsidiaries and branches** | 5.1 | 6.7 | 1.6 | 6.5 | 9.1 | 2.6 | 5.7 | 7.9 | 2.1 |
| **Total** | **100.0** | **100.0** | **0.0** | **100.0** | **100.0** | **0.0** | **100.0** | **100.0** | **0.0** |

*Source: Statistic Canada. Retrieved June 6, 2007, from http://www.statcan.ca/english/research/11-621-MIE/2006041/tables/table2.htm.*

## Appendix 5 – Top 10 Credit Unions in Canada by Asset Size

| Current Rank | Credit Union | Province | 2Q 2006 | 4Q 2005 | Members | Locations | Previous Rank |
|---|---|---|---|---|---|---|---|
| 1 | Vancity | BC | $10,249,203,392 | $10,166,463,438 | 343,192 | 49 | 1 |
| 2 | CCS | BC | 8,242,871,339 | 8,210,264,996 | 352,930 | 51 | 2 |
| 3 | Meridian | ON | 3,699,326,347 | 3,491,952,761 | 207,278 | 44 | 3 |
| 4 | Capital City Savings | AB | 2,736,425,116 | 2,498,852,463 | 151,391 | 41 | 4 |
| 5 | Envision | BC | 2,607,741,539 | 2,408,983,757 | 79,411 | 19 | 5 |
| 6 | Conexus | SK | 2.173,320,725 | 1,433,687,917 | 119,201 | 46 | 13 |
| 7 | Community | AB | 2,147,777,553 | 2.065,319,063 | 104,572 | 27 | 6 |
| 8 | Steinbach | MB | 1,907,968,900 | 1,765,326,971 | 64,003 | 2 | 8 |
| 9 | Prospera | BC | 1,770,512,662 | 1,657,711,999 | 48,229 | 17 | 10 |
| 10 | Desjardins | ON | 1,741,777,810 | 1,801,699,670 | 47,361 | 25 | 7 |

*Source: Credit Union Central of Canada. The Largest 100 Credit Unions: Second Quarter 2006. Toronto, ON, September, 2006, p. 2.*

## Appendix 6 – Technology and Payment Services CUCBC

### Technology

- Credit union access to evolving payment systems: MemberDirect™ (Internet banking, personal and business versions), Interac (direct debit), smart cards and credit cards
- MemberConnect™ content management and public website solutions
- Website construction, graphic design and administration
- Liaison/coordination with external systems suppliers
- Internal clearing and settlement systems
- For more information about the MemberDirect™ family of products and other technology services, please click on the E-Commerce button, this section or, go to: http://ecommerce.cucbc.com.

### Payment Services

- Item processing (centralized Canadian and US $ clearing, deposit and returned item processing)
- Tracing domestic and foreign wire transfers, credit union clearing and deposit items
- AFT (originating and receiving direct deposits, pre-authorized debits)
- Electronic and paper bill payments
- ABM/POS network settlement
- Cheque imaging
- Currency ordering
- Funds transfers
- Credit union current accounts
- CSB redemptions and transfers of ownership
- CAIS and NISA accounts
- Operation of MemberDirect™ Service Bureau
- Report and file distribution
- Remittance processing/payment consolidation

*Source: CUCBC. Retrieved June 6, 2007, from http://www.cucbc.com/aboutus/corefinancialList.html.*

## Appendix 7 – Cooperative Principles of Credit Unions

The following list represents the fundamental cooperative principles followed by credit unions.

1. Voluntary and open membership
2. Democratic member control
3. Member economic participation
4. Autonomy and independence
5. Education, training and information
6. Cooperation among cooperatives
7. Concern for community

*Source: CUCBC. Retrieved June 30, 2007, from http://infocentre.cucbc.com/_html/coop_principles.html.*

# Appendix 8 - Summary of Canadian Deposit Insurance Limits

The following table illustrates the variation in deposit insurance coverage as provided by the various provincial deposit insurance agencies across Canada.

| Deposit Insurer | Amount |
|---|---|
| Canada Deposit Insurance Corporation | $100,00 |
| Credit Union (CU) Deposit Insurance Corp. of BC | $100,000 |
| Alberta CU Deposit Guarantee Corp. | 100% |
| Saskatchewan CU Deposit Guarantee Corp. | 100% |
| CU Deposit Guarantee Corp. (Manitoba) | 100% |
| Deposit Insurance Corp. of Ontario | $100,000 |
| Quebec Deposit Insurance Board (QDIB) | $60,000 |
| CU Deposit Insurance Corp. (PEI) | $60,000 |
| Nova Scotia CU Deposit Insurance Corp. | $250,000 |
| New Brunswick CU Deposit Insurance Corp. | $60,000 |
| Newfoundland & Labrador CU Deposit Guarantee Corp. | $250,000 |
| Compcorp Canadian Life insurance issuers | $60,000 + |

*Source: Fiscal Agents Financial Services Group. Retrieved June 6, 2007, from http://www.fiscalagents.com/newsitems/cdic.shtml.*

## Appendix 9 - Canadian bank Web performance benchmarks

| Rank | Bank | Response time (sec) | Bank | Availability (%) | Bank | Consistency (sec) |
|---|---|---|---|---|---|---|
| 1 | **CCS** | 3.71 | TD | 99.97 | Vancity | 2.68 |
| 2 | TD | 4.59 | BMO | 99.96 | TD | 2.92 |
| 3 | RBC | 4.78 | **CCS** | 99.70 | RBC | 3.15 |
| 4 | Vancity | 4.97 | Citizens Bank | 99.43 | President's Choice | 3.89 |
| 5 | Citizens Bank[51] | 5.06 | Vancity | 99.43 | **CCS** | 4.16 |
| 6 | BMO | 5.19 | RBC | 99.34 | Scotiabank | 5.14 |
| 7 | President's Choice[52] | 6.18 | President' Choice | 99.30 | CIBC | 5.30 |
| 8 | Scotiabank | 11.73 | Scotiabank | 99.21 | President's Choice | 5.44 |
| 9 | CIBC | 12.29 | CIBC | 98.37 | HSBC | 5.88 |
| 10 | HSBC | 14.08 | HSBC | 97.05 | BMO | 6.43 |
| **Average** | | 7.26 | | 99.16 | | 4.50 |

*Source: Gomez.com. Retrieved June 16, 2007, from http://www.gomez.com/products/viewbenchmark.php?btype=9 for May, 2007.*

[51] Internet-only bank. A subsidiary of Vancity.
[52] Internet-only bank. A partnership between Loblaw Companies Ltd. and CIBC.

## Appendix 10 – Top 10 British Columbia Credit Unions 2005

| Rank | Credit Union | Assets | Membership |
|---|---|---|---|
| 1 | Vancity | 10,166,463,438 | 335,653 |
| 2 | CCS | 8,210,264,996 | 339,890 |
| 3 | Envision | 2,408,983,757 | 78,795 |
| 4 | Prospera[53] | 1,657,711,999 | 48,431 |
| 5 | Interior Savings | 1,460,106,311 | 82,082 |
| 6 | Westminster | 1,313,197,732 | 51,119 |
| 7 | Coastal Community | 1,255,552,377 | 82,741 |
| 8 | North Shore | 1,206,371,062 | 36,468 |
| 9 | Valley First | 971,699,416 | 44,073 |
| 10 | Island Savings | 875,390,659 | 37,870 |

*Source: Adopted from CUCBC. Retrieved July 20, 2007, from http://infocentre.cucbc.com/_html/statistics.html/06_cu-assets.pdf.*

[53] Prospera and North Shore are merging in 2007.

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