A STRATEGIC ANALYSIS OF A GROWTH-ORIENTED CREDIT UNION

by

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ABSTRACT

The financial services industry is undergoing considerable change. Competition, as well as the sophistication of users of financial services is increasing. With a favourable regulatory environment encouraging competition, this industry is attracting competitors from non-banking industries. Technology, especially the internet, has changed how firms deliver financial services to consumers and it has increased the ability for consumers to comparison shop. Technology has also enabled competitors to enter the market with low-cost, e-banking strategies resulting in increased price competition and shrinking margins.

Credit unions, with their small scale and branch delivery models, are finding it increasingly difficult to compete in this market. As a result, there has been a steady stream of B.C. credit unions merging in order to achieve scale efficiencies. In March of 1997, there were 97 independent credit unions in B.C. As at May 1st 2004, there were only sixty credit unions.

As a result of pressure to achieve greater scale efficiencies, the CEO of G&F Financial Group has adopted a merger growth strategy and, since 2001, has lead his credit union through three mergers, increasing the asset size under his direction from $53 million to almost $650 million. This paper explores whether G&F should shift its current focus on growth through amalgamation, and consequent emphasis on efficient integration, to a focus on increasing market share through enhancing its competitive position by differentiating its products and services.

This strategic analysis commences with an overview of G&F Financial Group, its products and services, and a discussion of consumer behaviour with respect to financial services. An industry analysis provides insights on the challenges faced by firms in this industry and discusses the implications for traditional bricks and mortar retail banking firms, particularly credit unions. The internal analysis reviews and discusses the credit union's activities, competencies, organizational structure, and financial performance to identify opportunities to improve its competitive positioning, and impediments to maximizing it competitive advantage. A discussion of the issues that G&F Financial Group must address in order for it to build a strong, competitive organization is followed by recommendations aimed to address these issues.

DEDICATION

I dedicate this paper to my husband, Richard, for supporting my decision to pursue my MBA. Even though he never did learn how to cook over the last two years, I appreciate the many other ways in which he supported me, especially the much-needed comic relief. I also want to thank my family and friends who stood by me over the last two years even though there were times when they thought I had fallen off the face of the earth. I thank them for their understanding and patience; it did not go unnoticed.

I also dedicate this paper to my team mates, Jennifer Pickrell and Michael Atkinson, whom I thank for making this journey a joy ride!

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Special thanks go to Richard Davies, Chief Executive Officer of G&F Financial Group for allowing me the privilege to use his credit union as the subject of this paper, and for providing me with access to his staff. I appreciated the time that he and the staff of G&F so generously gave to me, particularly since I was doing this paper at the peak of merger integration. I thank Ken, Robyn, Bill, Martin, Jeff, Patrick, and Juliana for sharing their knowledge, insights and honesty.

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1 PRODUCTS, MARKETS AND OVERVIEW OF THE FIRM

1.1 Firm Overview

Gulf and Fraser Fishermen's Credit Union, operating under the trade name of G&F Financial Group (G&F), has assets in excess of $650 million and is the tenth largest credit union in British Columbia. This credit union has only recently grown to its current size because of an amalgamation of United Savings Credit Union (United) and G&F on May 1st 2004. This new entity has twelve branches located in Richmond, Burnaby, New Westminster, Surrey, and Vancouver and will open two new branches in Port Coquitlam and Surrey this summer. It also has two subsidiaries, an insurance/wealth management subsidiary and a holdings company. The insurance/wealth management subsidiary has two offices, located in Vancouver and Richmond. The holdings company is used for dealing with GST related to property rental income. G&F employs 160 people and serves 30,000 members.

Over the last ten years, the President and Chief Executive Officer of G&F, Richard Davies, has orchestrated a series of mergers to grow the asset size of the credit union. As the General Manager of Dairy Industry Credit Union, he merged with the Pioneer Savings Credit Union (1994), United Savings (2001), Allied Savings (2002), and G&F (2004). The asset size under his direction has grown from $15 million to almost over $650 million in a ten-year period. His goal is to continue to grow the credit union's assets to surpass $1.0 billion by 2008.

1.1.1 Credit Unions versus Banks

Although banks and credit unions generally offer similar products and services, credit unions and banks differ in several important respects. Credit unions are provincially regulated whereas banks are federally regulated. As a result, credit unions across Canada operate under the provincial regulations of the province in which they are located, and their operations are restricted to that province. Financial institutions that operate across provincial boundaries fall under federal jurisdiction and, therefore, operate under yet another set of regulations. Should a credit union wish to operate outside its provincial boundaries, it must receive approval from the federal regulators to become established as a "bank." For example, several credit unions have established "virtual banks" that offer banking services across the country via the internet and call centres.

Differences in ownership structure are also significant. Credit unions are financial cooperatives and, as cooperatives, are democratically owned and operated by their members based on one member, one vote. Credit unions reinvest profits in the credit union, and share

them with members and the communities in which the credit union operates. For banks, owners and customers are not the same. Bank profits accrue to the shareholders and are not redistributed to the customers of the bank. B.C. credit unions also provide a higher level of deposit protection to members than that provided by banks. Credit unions insure deposits to a maximum of $100,000 per separate deposit whereas banks insure only a maximum of $60,000 per depositor per institution.

1.1.1.1 History of Credit Unions in British Columbia

With the depression of the 1930's, banks had little interest in dealing with those individuals with small savings or lending needs. Due to an unmet need for places to save or borrow from, the credit union movement found fertile ground in B.C. The first credit union in B.C., Common Good Credit Union, opened its doors in 1936 as an alternative to chartered banks. The credit union movement grew in B.C. as groups of individuals with a common bond such as community, church, industry, cultural heritage, and union affiliation came together to develop their own financial co-operatives. These common bonds became the basis for membership. While common bond credit unions continue to exist today, the majority of B.C. credit unions have developed more inclusionary membership models wherein anyone in B.C. may join almost any credit union. However, the religious, cultural, and occupational roots of many these credit unions are still evident in the membership profiles of credit unions today.

1.1.1.2 History of Gulf and Fraser Fishermen's Credit Union

Like other B.C. credit unions, G&F has evolved through the merger of numerous small credit unions serving markets that were under-represented by the chartered banks. Prior to the merger with United Savings Credit Union, G&F's roots were in the fishing industry. Established in the 1940's, it was bonded to represent commercial fishing from Whonnock to the mouth of the Fraser River. In 1953, it expanded its bond to include "any and all fishing industry workers and their relatives in B.C." and, in the 1970's, it redefined its community of membership as "anyone who eats fish." [1] As a closed bond credit union, it operated much like an open/community bond credit union. In the late 1990's, it merged with Elco Credit Union which represented employees of B.C. Hydro. At the April 2004 Annual General Meeting, the membership approved opening the bond to represent all "persons who work, reside or carry-on business in the Province of British Columbia."

United Savings Credit Union achieved much of its growth through a series of mergers of many small credit unions that represented specific industries and unionized employees. Founded

in the 1940's by City of Vancouver employees that were members of the Civic Employees Federation of Unions, the credit union later expanded to include all employees of the City of Vancouver and their immediate families. After several mergers, in 1993, United changed its bond to a province wide, community bond.[2]

In 2001, United merged with Burnaby Savings Credit Union. Burnaby Savings was the result of a merger in 1994 between Pioneer Credit Union and the Dairy Industry Credit Union. The first credit union in B.C., under the original name of Common Good Credit Union, Pioneer was the result of mergers of many small, closed bond credit unions established during the depression. In 2002, United Savings acquired the assets of Allied Savings Credit Union, which also had a history of representing the employees of various industries including the B.C. Sugar Refinery and the Canadian National Railway.

1.2 Purpose of Paper

The purpose of this paper is to complete a strategic analysis of G&F Financial Group. This paper analyzes the credit union's ability to compete effectively in an increasingly competitive market. With the recent volume of merger activities, and its rapid increase in size, this paper approaches the strategic analysis from the perspective of the impact that the mergers have had on building its competitive strength in the financial services industry. The first chapter of this paper describes G&F's products and services, markets, and revenue streams. It also provides an overview of consumers' attitudes and behaviours with respect to financial services. The second chapter is an analysis of the retail banking industry from five perspectives – threat of entry, rivalry among existing competitors, threat of substitute products and services, bargaining power of suppliers and bargaining power of customers. The internal analysis of G&F in Chapter three discusses G&F's strategic fit, its value chain and core competencies, and financial position. Chapter four discuss the issues facing G&F and is followed by recommendations in Chapter 5.

1.3 Products and Services

G&F provides a full range of financial services and products to its members via its retail banking operations and insurance/wealth management subsidiary. It also offers online, telephone and ATM banking services to its members.

1.3.1 Retail Banking Products and Services

G&F offers a full range of retail banking products comparable to those offered by banks and other credit unions. Retail banking products fall into two primary categories – personal

banking and commercial banking. Personal banking products and services serve the personal banking needs of individuals and commercial banking products and services serve the needs of small and large businesses. Although some products may vary from those of competitors, G&F's retail banking products and services are largely undifferentiated.

1.3.1.1 Personal Banking

Primary personal banking product categories include personal loans, mortgages, demand accounts (registered and non-registered), and term deposits (registered and non-registered). Within each of these product categories, there is a variety of products designed to meet specific member needs. For example, for those members that are comfortable with locking-in their investment for a specified term, a term deposit product with a higher interest rate, but an early redemption penalty is available; for those who may want to access the invested funds, a term deposit that allows early redemption without a penalty is available, but at a lower interest rate. Through its retail banking branches, G&F also offers other investment products and services such as sale of the "top 100 mutual funds" and the credit union system's proprietary "Ethical Funds."

G&F also offers other standard financial services such as automated bill payment processing, safekeeping and foreign exchange. Card products include a MemberCard for point of sale transactions and ATM access, and a MasterCard credit card. The MasterCard is linked to a membership rewards program called "Choice Rewards." With the Choice Rewards program, cardholders earn points that may be redeemed for travel and merchandise.

1.3.1.2 Commercial Banking

Business members not only have access to many of the same account options available to individuals, additional service options are available that meet the needs of commercial members such as night depository services, electronic point-of-sale devices, and business credit cards. Financing of business activities is a significant component of the offering for small businesses, particularly the provision of financing to builders. With its roots in the fishing industry, G&F also specializes in financing of fishing vessel purchases.

To meet the needs of small business, G&F offers a commercial line of credit up to $25,000 that is secured based on a covenant or the member's residential mortgage. This eliminates the need for business members to file annual financial statements and increases the speed in which line of credit applications are processed.

1.3.2 Insurance Services

G&F has operated its insurance subsidiary, Gulf and Fraser Insurance Services Ltd., since 1986. G&F expanded into insurance services in order to expand its service offering to its members, not to generate a profit. It has two offices, one in Vancouver, and the other in central Richmond. Insurance products include auto, home, travel, life and disability, and commercial insurance. Unlike retail banking services, insurance services are available to both members and non-members.

The fate of the insurance subsidiary is undetermined. G&F recognizes that the resources used to run the insurance agency could generate a greater return if redirected into retail banking operations.

1.3.3 Wealth Management Services

In 1998, G&F branched out from traditional banking services by expanding into wealth management through its insurance subsidiary. G&F decided to expand into wealth management in order to reduce its vulnerability related to market swings; when the investment market is providing greater returns than term deposits, deposits leave the credit union and often do not return. By offering a full spectrum of investment vehicles, the credit union is able to offer products that are attractive during different market cycles. In addition, the credit union is able to meet the changing financial needs of its aging members. As members age, the demand for lending products declines and demand for financial and retirement planning services increases. The sale of investment products and provision of investment services not only generates revenues for G&F, but also strengthens G&F's relationship with its members.

The wealth management products and services offered through the subsidiary include investment account management, personal financial planning, retirement savings planning, wills, and estate planning. In addition, it sells a wide variety of investment products such as mutual funds, stocks, bonds, segregated funds and annuity contracts. To provide financial planning and investment advice, G&F's subsidiary has two Financial Planners each with a Certified Financial Planning License. As part of the insurance subsidiary, the Financial Planners are permitted to sell insurance products (e.g. individual life and casualty) which they are not permitted to sell if they are located in the credit union branch.

United introduced professional financial planning services in 2003 and offers these services through its branches, rather than through a subsidiary. United's sole Financial Planner does not sell insurance products and, therefore, is permitted to operate from the retail banking

branches. The merged credit union is still operating both models of professional financial planning delivery and has not yet determined how it will deliver these services in the future.

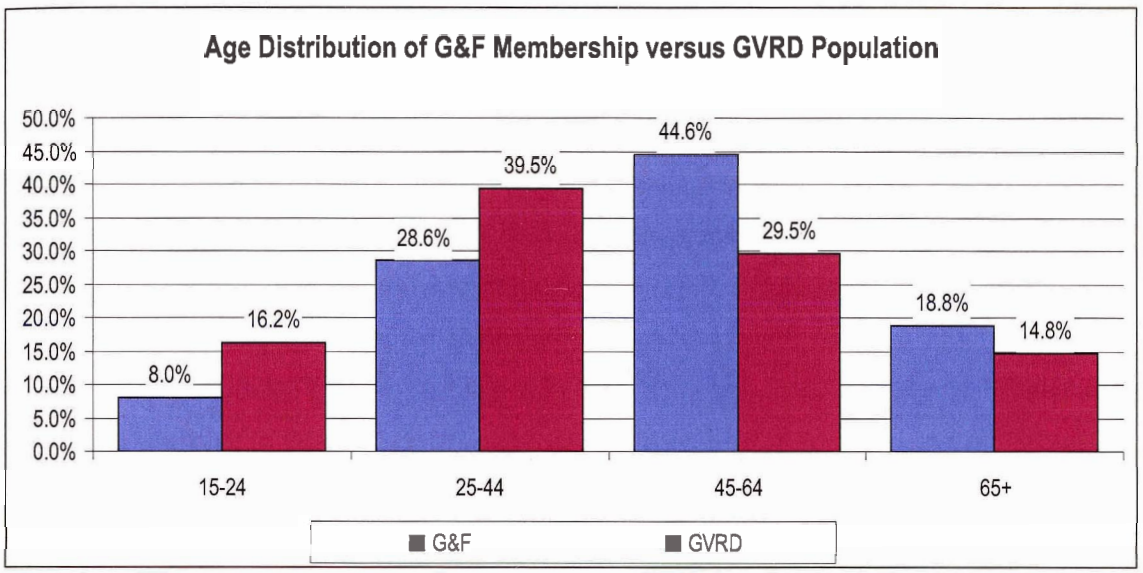
1.4 Target Market

An estimated 25% of the credit union's membership have links to the original roots of one of the many credit unions that make up today's G&F. The remaining 75% of members come from the communities in which the credit union operates. Currently, G&F is not targeting a specific market. With limited growth in many of the communities in which it has branches, efforts are concentrated on controlling business going out the back door, versus trying to bring business through the front door. Therefore, marketing activities focus primarily on expanding share of wallet of existing members with less emphasis on increasing market penetration in the communities in which it operates.

Prior to the merger, each credit union's marketing activities suggest some differences in demographic focus. G&F's marketing and promotion activities focused on mature members, whereas United seemed to promote something for everyone across all stages of the lifecycle. G&F's greater focus on mature members is evidenced by its increased emphasis on wealth management and recent renaming from Gulf and Fraser Fishermen's Credit Union to G&F Financial Group. The new branches opening in Surrey and Port Coquitlam will focus on attracting younger families and mortgages.

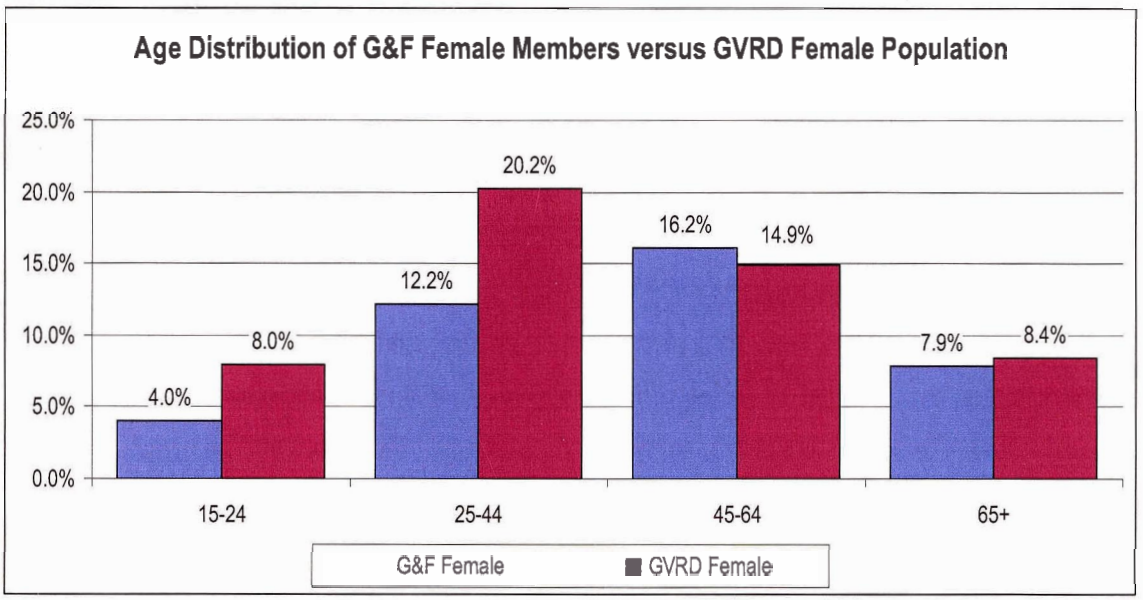
Figure 1 below shows the age distribution of G&F's membership, post-merger, versus the population of the GVRD. Relative to the population, G&F's membership reflects a greater proportion of people aged 45 years and older, and an under-representation of those aged 15 to 44.

Figure 1: Age Distribution of Members versus GVRD Population[3]



G&F's membership data also indicates an under-representation of females among the 15 to 44 year age group relative to the GVRD population.

Figure 2: Age Distribution of Female Members versus GVRD Female Population[4]



1.5 Market Share, Revenue Streams and Pricing

1.5.1 Retail Banking

Credit unions comprise a small portion of the B.C. retail banking market with chartered banks dominating this market. With just over $29 billion in total assets, B.C. credit unions hold

20.9% of the total assets of deposit-taking institutions in B.C.[5] G&F's and United's combined total assets of $642.3 million at the end of 2003 comprised a mere 2.21% of B.C. credit union system total assets and .46% of total assets of all deposit-taking intermediaries in B.C. With just under $600 million in combined deposits at the end of 2003, the combined deposit portfolio for G&F and United comprised only .56% of total funds on deposit with B.C. deposit-taking intermediaries. In terms of share of the Greater Vancouver market, United's and G&F's market share of credit union assets is conservatively estimated at 3.0% and the combined member count comprises approximately 3.4% of the credit union members in the GVRD.[6]

Growth related to mergers has increased G&F's market share. However, the credit union has no data available to indicate how its non-merger related growth compares to the market size. The trend among B.C. credit unions overall is not promising. In recent years, B.C. credit unions have experienced a decline in market share in terms of proportion of the adult population dealing with a credit union as a primary financial institution and in terms of specific product usage. CUCBC's products and services study found that the percentage of British Columbians that deal with a credit union dropped from 41% in 2002 to 38% in 2003. Further, credit unions do not come close to having 38% market share on any of their product offerings. Between 2002 and 2003, credit unions lost market share in all product categories except business accounts. Interestingly, credit unions did not lose their market share to the banks as the banks also experienced a loss of market share across all product categories. Although it is possible that G&F's performance is contrary to the overall system trend, the declining market share among B.C. credit unions may be evidence of challenges that G&F will face in terms of organic growth.

1.5.2 Wealth Management

At a stable 32%, banks have the largest market share of those consumers seeking investment and retirement advice. Credit unions lost four points in market share dropping from 11% to 7% between 2002 and 2003. Credit unions also lost market share on insurance advice experiencing a dramatic drop from 12% in 2002 to 5% in 2003. Banks, however, increased market share on insurance advice from 16% to 24% over this period. Similar results occurred in the areas of tax advice, estate advice, and mutual fund investments wherein credit unions lost ground and banks gained.[7] An estimated 5% of G&F members use the services of the wealth management subsidiary, and this 5% of members represent the majority of the subsidiary's client base. As a late entrant into this market, G&F holds an insignificant portion of the overall financial planning market. However, in the last two years, funds under administration have

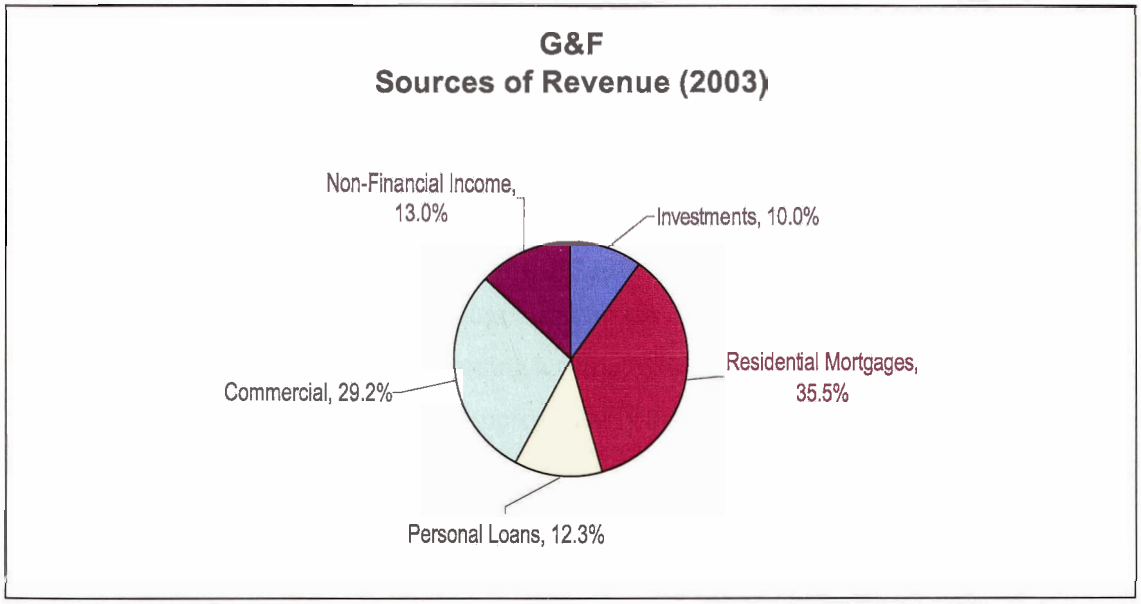
grown from $18 million to $52 million. Most of this growth is attributed to word-of-mouth advertising, and as people develop a comfort level with their advisor, they slowly bring over more money for investment.

When G&F decided to pursue this market in the late 1990's, experts in the industry were saying that wealth management was where retail banking firms should be focussing and that it would be increasingly difficult to make money in retail banking. G&F followed this advice and decided to focus on building its wealth management functions. Its vision was that one day wealth management would become the primary business, and retail banking a supplementary business. With the merger with United, the direction for the wealth management division is undecided.

1.5.3 Revenue Streams

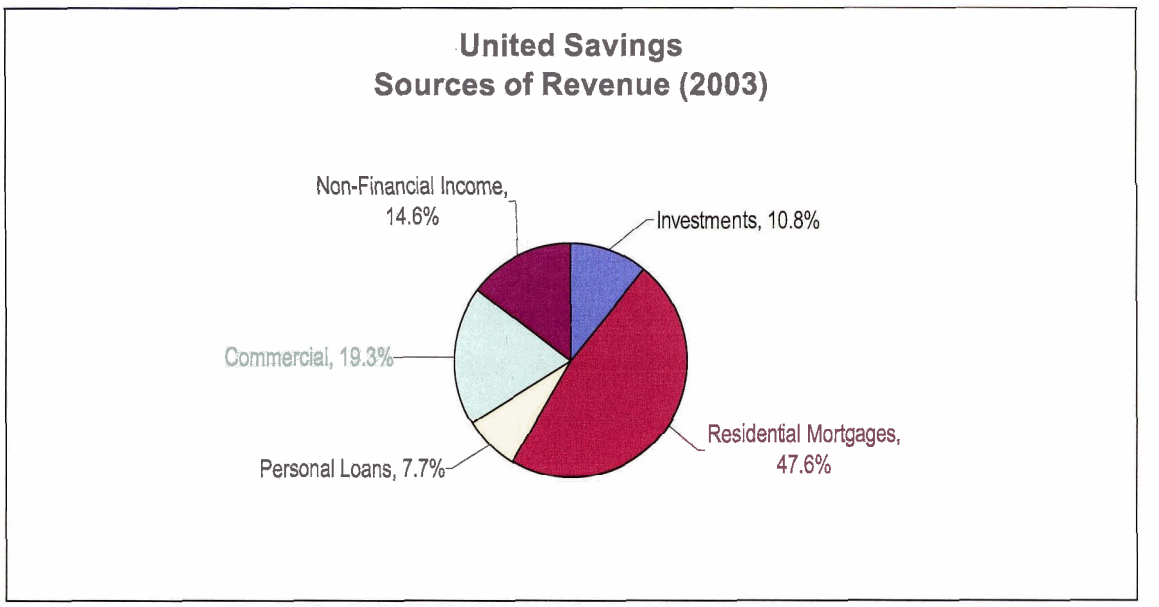
G&F's two primary revenue streams for banking operations are financial income and non-financial income. Financial income represents interest income generated from lending and other investment activities. In 2003, financial income comprised 85% of United's total income and 89% of G&F's total income. As illustrated below in Figure 3 and Figure 4, the majority of G&F's and United's financial revenues come from residential mortgages. Commercial loans are the second most prevalent source of revenue with G&F generating a greater portion of its financial income than United from commercial lending activities.[8]

Figure 3: G&F Sources of Revenue (2003)[9]



Non-financial income is all other income that the credit union earns from the various fees that it charges for its services such as transaction fees, account service fees, service charges (e.g. NSF cheque handling and safe deposit box rental) and commissions (from the sale of third party products such as the in-branch sale of mutual funds). In 2003, this comprised 13% of total income for G&F and 14.6% for United.[10]

Figure 4: United Savings - Sources of Revenue (2003)[11]



Included in G&F's non-financial income are the gains/losses from its insurance/wealth management subsidiary. In 2003, the subsidiary lost close to $100,000. Table 1 below reports the subsidiary losses borne by the credit union over the last four years. However, the subsidiary earnings reported below must be put in perspective. First, credit unions pay the small business tax rate whereas their subsidiaries pay taxes at the higher corporate tax rate. As a result, credit unions reallocate as many expenses as possible from the credit union to their subsidiaries. In addition, G&F received bad advice regarding a compensation arrangement with its Financial Planners that is costing the credit union approximately $80,000 per year. The arrangement is due to expire at the end of 2005.

Table 1: Subsidiary Earnings (2000-2003)[12]

	G&F 2000	G&F 2001	G&F 2002	G&F 2003
Subsidiary and Other Equity Investment Earnings - Net	-$827	-$58,780	-$116,942	-$96,906

1.5.4 Pricing

Each credit union's pricing of products and services has followed different philosophies. Therefore, one of the primary marketing activities with the merger is to not only streamline the product and service offering, but also review pricing.

United's pricing philosophy was to charge fees just below the median of the market. Unlike most financial institutions, United did not charge a fee for in-branch transactions, yet it charged a fee for electronic transactions. The rationale for this approach was to encourage members to come into a branch as this would create opportunities for relationship building. In addition, United was opposed to surcharging members for personal service. United's pricing of loan rates was also fairly aggressive in that its posted loan rates were lower than market, and members were able to negotiate lower rates. At the end of the year, depending on the profitability of the credit union, members received a patronage rebate based on the amount of loan interest they paid during the year.

G&F's pricing philosophy has been to offer lower prices than the market, but due to lack of regular product and pricing reviews, pricing was inconsistent relative to this philosophy. In fact, while the pricing of some products was so aggressive that there was no spread, other services were priced high relative to the market. G&F did charge its members for in-branch transactions. Up until 2003, G&F did not offer a patronage rebate to its members.

The new pricing philosophy is to continue to offer competitive rates that are marginally better than its primary competition on all deposit and lending products; however, there is no attempt to be the "low cost" provider. G&F also will adopt United's no fee approach for conducting in branch transactions.

1.6 Buyer Behaviour

1.6.1 Financial Institution Usage and Attitudes

Comprehensive market research has been conducted to understand the behaviour of consumers of financial services products and trends in behaviour.

1.6.1.1 Primary Financial Institution

In late 2003, G&F and United commissioned surveys on member satisfaction and banking behaviour. The level of loyalty among members of each of United and G&F differ considerably, with United having notably higher levels of loyalty than G&F.

Table 2: Member Loyalty

	% of Members Indicating Sole Institution	% of Members Indicating Principle or Sole Institution
G&F Members[13]	16.1%	35.0%
United Members[14]	31.4%	54.0%
B.C. Credit Union Members[15]	26.0%	59.0%

The results indicate that 16.1% of G&F members deal solely with G&F, considerably lower than the provincial credit union average of 26%. Conversely, the percent of United members that deal solely with United is higher than the provincial average with 31.4% of United's members dealing solely with it. Overall, 35% of G&F's members consider it to be their primary or sole financial institution, versus 54% for United. Both of these are lower than B.C. provincial average of 59% for combined sole and primary membership.

1.6.1.2 Satisfaction with Financial Institution

The proportion of United and G&F members that report being highly satisfied with their credit union is greater than the proportion of B.C. adults (65%) that report being highly satisfied with their financial institution.[16] The results of United's member survey indicates that 82.1% of its members surveyed rated their overall satisfaction as strongly positive (a rating of 8, 9 or 10 out of 10) and 2.0% rated it as strongly negative (a rating of 1, 2, or 3 out of 10). However, this 2.0% is concentrated in two branches with 5.4% and 5.9% of members reporting negatively about their level of overall satisfaction.

G&F's member survey reported fewer "strongly positive" ratings than United with regard to overall satisfaction with meeting banking expectations – 76.7% of G&F members surveyed reported strongly positive satisfaction ratings. Although G&F may not delight as many of its members as does United, it also does not dissatisfy as many members as does United – less than one percent of G&F members surveyed reported strongly negative satisfaction ratings.

Among the B.C. population, of those who deal most often with a credit union, 65% report being "highly satisfied" with their relationship with their financial institution whereas only

39% of those who deal mostly with banks, and 36% who deal primarily with trust companies, report being highly satisfied with their financial institution.[17]

As shown in Figure 5, G&F's and United's members expressed a high level of satisfaction with the services they receive from their credit union. However, members reported lower levels of satisfaction with the interest rates and fees charged by the credit union, and with the accessibility and number of branch locations.

Figure 5: Member Satisfaction with Service and Offering – 2003 Member Survey Results[18]

1.6.1.3 What Consumers Want

Although it is important for members to be highly satisfied with the services they receive, it is more important that the high satisfaction ratings are attributes that members consider important. According to CUCBC's "Barriers and Motivators" research, when dealing with a financial institution, consumers rate service as most important, followed by competitive rates, and access. Corporate attributes are least important. Table 3 on the following page compares the level of importance consumers place on each attribute to how well they believe that credit unions and banks are doing relative to that attribute. A positive number under "Gap"

indicates that consumers rate credit unions as performing better on that attribute, and a negative number indicates consumers rate banks as performing better on that attribute.

On all of the service attributes, credit unions are perceived by consumers to outperform banks. However, a considerable gap exists between the proportion of the population that rate service attributes as important, and the proportion that rate credit unions as having that attribute. Banks outperform credit unions on all access attributes and all products/rates attributes except service fees. While banks fall short of consumer expectations on some of the access and product/rate attributes, the gap is very small for many of the attributes and, for some attributes, banks are exceeding the expectations of British Columbians.

Table 3: Importance of Attributes of Financial Institution[19]

Group	Attributes	Importance	Credit Unions	Banks	Gap
Service	Address complaints and problems quickly	94	51	40	+11
Service	Have knowledgeable staff	93	50	39	+11
Products / Rates	Offer competitive interest rates on loans and mortgages	93	54	62	-8
Access	Allow access to accounts at any ATM in Canada using a bank card	92	50	90	-40
Products / Rates	Have reasonable service fees	91	41	29	+12
Products / Rates	Offer a complete range of financial services	87	57	83	-26
Service	Make their customers feel welcome	86	62	41	+21
Service	Work hard to develop a relationship with their customers	84	53	31	+22
Access	Have convenient branch locations	83	47	79	-32
Access	Allow access to funds remotely, through telephone or Internet banking	81	53	85	-32
Corporate	Have flexible policies	78	47	34	+13
Service	Take a real interest in your financial future	75	47	37	+10
Corporate	Share their profits in the community	73	57	14	+43
Corporate	Have extended banking hours	64	44	32	+12
Corporate	Have low staff turnover	58	41	29	+12
Access	Be locally owned and operated	52	71	14	+57

Despite the fact that credit unions outperform banks on the attributes that consumers rate as being of greatest importance, credit unions' market share has been declining. This data seems to suggest that banks and credit unions are both doing a poor job at meeting consumer expectations, and that credit unions are simply doing a less poor job. Considering that both banks and credit unions lost market share in 2003 over 2002, these gaps in service delivery suggest that consumers are finding other ways to meet their needs.

1.6.1.4 Willingness to Switch Financial Institutions

Even if given bad service, 50% of Canadians are unlikely to change their financial institution.[20] Seniors and those who have a positive view of the financial services industry are the least willing to change financial institutions. Interestingly, the willingness to change financial institutions decreases as level of education increases.[21] The propensity to switch financial institutions has been relatively stable since 1992 with 65%-69% reporting having not switched financial institutions in the previous five years. The reasons cited for switching have also remained relatively stable over this same period. The top reasons cited are poor service (38%), location convenience (24%), and fewer/lower service charges (19%).[22]

1.6.1.5 Attitudes toward Financial Institutions

In recent years, banks have come under public criticism with respect to their high profits. Of the one-third of Canadians that feel that Canadian corporations make too much money, 78% feel that banks make too much money, ranking second to the oil and gas industry. Credit unions are rated more favourably than banks in this regard with only 29% feeling that credit unions make too much money. Consumers also view credit unions more positively than banks in terms of ethical and moral standards (57% favourable for credit unions versus 48% favourable for banks). In addition, credit unions are considered to be operating better than banks with 42% reporting credit unions are functioning well versus 29% for banks. [23]

1.6.1.6 Insights on Buyer Behaviour

Based on the market studies, G&F and United are generally performing well in terms of their service levels, acknowledging some challenges with consistency in service across branches. However, United does tend to "delight" more of its customers and generally rates more positively on all service attributes than does G&F. While the differences are not significant, the level of member loyalty is considerably higher among United's members. Unfortunately, no historical data is available to identify trends in loyalty levels among members that could provide some insights on these differences. To the degree that consumers rate service attributes as very important in the selection of a financial institution, and poor service is the top reason for switching financial institutions, the post-merger G&F appears well positioned to maintain and improve member loyalty. With an increased number of branches to serve members, members' dissatisfaction around accessibility should also reduce, with the potential to reduce the need for members to deal with multiple financial institutions.

The consumer data also indicates that credit unions are viewed more positively than are banks in terms of service levels, ethics and level of profitability. Unfortunately, it will be difficult for G&F to capitalize on the positive views of credit unions because G&F consciously eliminated all references to "credit union" when it changed its name. This could affect its ability to attract new members, particularly as it expands into new communities.

1.6.2 Channel Selection

Consumers have a variety of channels available to them for conducting transactions – internet banking, automated teller machines (ATM), telephone banking and in-branch teller services. According to CUCBC's products and services study (2003), ATMs are the most commonly used channel among British Columbians, followed by in-branch teller services, internet banking, and telephone banking. The rapid increase in the adoption of internet banking correlates with decreasing usage of ATMs and in-branch teller services.[24]

Delivery channel usage among G&F and United members differs considerably from the findings of CUCBC's products and services study in that in-branch teller service is the most commonly used channel (59% for G&F and 49% for United) with ATM usage placing a distant second among United members and third among G&F members. (Telephone banking ranked second in usage among G&F members).

1.6.2.1 Automated Teller Machines

The percentage of Canadians reporting usage of automated teller machines has increased from 64% of Canadians in 1992 to 91% in 2003, but has been declining since 2000. This decline is due to the increased growth in direct payment usage and internet banking. On average, United members report using ATM's to conduct 28% of their transactions and G&F members report considerably lower usage with an average usage of 15%.[25]

1.6.2.2 Internet Banking Services

Consumers are increasingly taking advantage of the ability to conduct their banking via the internet. The percent of adult Canadians reporting using internet banking has grown from 10% in 1999 to 34% in 2003, with an increase of seven percentage points in the last year.[26]

In B.C., 47% of adults surveyed reported having internet banking, with 76% having internet banking with a bank and the remaining 24% with a credit union. Internet banking usage is highest among 19-34 year olds, better-educated individuals, and those with higher household incomes.[27] This 24% is slightly lower than the market share representation for primary and sole users of credit unions, suggesting a slower adoption of technology by credit unions and/or their

members. The adoption of online banking is considerably lower among G&F and United than among the population overall and credit unions overall. Approximately 16% of the combined membership has signed-up for online banking and the total number of members from each credit union with online banking is roughly equal. The lower adoption rates among the United and G&F members is likely attributed to the higher average age of its membership as older people are less likely to use technology, especially the internet, to do their banking.

1.6.2.3 In-Branch Banking

Despite the growing level of acceptance of alternative methods for conducting personal banking, a large percentage of Canadians still bank in-person. The Public Interest Advocacy Centre survey found that 67% of respondents had banked in-person in the previous month.[28] Interestingly, even if a consumer rarely banks in-person, 76% want to have a branch nearby.[29]

In-branch teller service is the most predominant channel used by members of United and G&F for conducting transactions. G&F members report using in branch services for an average of 59% of their transactions and United members report using in-branch teller service for an average of 49% of their transactions. As with internet banking, the higher average age of G&F's and United's membership correlates with the tendency for older people to favour in-branch teller services for conducting their banking transactions.

1.6.3 Credit Products

The low interest rates and generous incentives offered by retailers in recent years have fuelled high levels of consumer spending resulting in increasing debt levels among Canadians. Canadians are not only spending and borrowing more, but they are also saving less. Unlike the past when people saved money to make a purchase, Canadian consumers have adopted a "buy now, pay later" approach. The number of Canadians with a mortgage is at an all time high, lines of credit have increased, and personal loans have remained relatively stable. Credit card usage is also at an all time high.[30]

1.6.3.1 Mortgages

The proportion of Canadians with a mortgage has been steadily increasing since 1995 and reached a high of 36% in 2003. While the majority (61%) have their mortgages held by their primary financial institution, this number has dropped from a high of 65% in 2001. Fifty-four percent indicated that they would shop around for a better mortgage rate and better package of fees and payment options when they renew their mortgage.[31]

Among British Columbians, 33% of primary credit union users have their mortgage with a bank, up from 17% in 2002, while only 6% of primary bank users have their mortgage with a credit union. The majority of homeowners (59%) apply for their mortgages by going in a branch, but this has been steadily declining; in 2000, this amount was 83%. Since 2001, the use of a mortgage broker has increased from 1% to 17%. In addition, there has been an increase in the proportion of borrowers receiving a personal visit from a representative (6% in 2002 to 10% in 2003). Sole credit union members were the most likely to visit a branch to apply for, or renew, a mortgage.[32]

1.6.3.2 Loans

The number of Canadians that reported taking out a personal loan in the last year (16%) has been relatively stable since 1998 (21%). Among those who have taken out a personal loan, an increasing number are getting their loans from a secondary financial institution. The number getting a loan from a secondary institution has increased from 30% in 1999 to 43% in 2003.[33]

The primary purposes cited for a loan is to purchase a vehicle (35%), do home renovations (12%), invest in an RRSP (11%), and education (9%).[34] In B.C., banks hold 54% of the RRSP loan market share and credit unions trail at 18% share. The majority of students (65%) have their loans with banks while a meagre 3% have their student loans with credit unions. Of all other personal loans, the banks dominate with 64% market share and credit unions trail behind with only 10% share.[35]

1.6.3.3 Line of Credit

Since 1993, the use of lines of credit has almost tripled. In 1993, only 16% of Canadians reported having a line of credit whereas in 2003, 43% of Canadians reported use of a line of credit. This growth, which increased from 17% to 28% over this period, has largely been among users of banks. The proportion of those dealing with credit unions/caisse populaires,[36] trust companies, and other financial institutions with a line of credit has remained stable.[37] The B.C. data shows that 41% of residents have a line of credit of $5,000 or greater and that 82% of this group have their line of credit with a bank.

1.6.3.4 Credit Cards

Ownership of credit cards has seen a steady increase, growing from 66% in 1999 to 78% in 2003 and, over this same period, the frequency of usage has increased. In 1999, 24% reported using their card one or more times per week compared to 32% in 2003. Credit card ownership increases with age; of those that own one or more credit cards, 68% are under 35, 80% are aged

35-49, and 86% over 50 years of age.[38] For those with more than one card, the primary reason cited for using one card over another was the ability to accumulate travel or air mile points (24%).[39]

1.6.3.5 Insights on Credit Usage

The increased use of various credit products and the changing attitude toward use of credit not only highlights opportunities to generate loan growth, but also suggests an increasing need for budgeting assistance. The increased debt level among Canadians, and particularly the increased usage of credit cards, suggests that an increasing portion of the population have over-extended their financial resources. When interest rates begin to rise, the need for budgeting assistance will increase as many people will find it difficult to service their debt. Increasing debt levels also put the credit union at risk that members will default on their payment obligations.

1.6.4 Insurance Services

Banks and credit unions share a very small percentage of the insurance market with most B.C. residents having their insurance policies with an insurance company. While banks and credit unions have equal share of the auto insurance market, credit unions have greater share than banks of the home insurance market. However, between 2002 and 2003, the percent of primary credit union users holding their insurance through the credit union dropped from 35% to 26%. Although there are several credit unions with large established insurance subsidiaries, the data suggests that credit unions have not made significant headway into this market.

Table 4: Share of B.C. Insurance Market[40]

	Automobile Basic	Automobile Comprehensive	Home
Insurance Company	80%	80%	60%
Bank	6%	5%	7%
Credit Union	6%	5%	11%
Other	8%	10%	12%

1.6.5 Investment Services & Wealth Management

A large portion of Canadians considers themselves "not very knowledgeable" or "not knowledgeable at all" about financial matters. Females (45%) rated their level of knowledge lower than did male respondents, and the level of knowledge regarding financial matters tended to increase with age with 48% of those under age 35 reporting a low level of knowledge. These

same two groups (females and under 35's) also reported greater desire for more information on financial matters.[41]

In terms of investment management, the number of individuals delegating all of their investment management activities has been slowly increasing (18% in 2001 and 22% in 2003). Although the number that fully handles their investment activities themselves has stabilized around 50% since 2000, this is a dramatic decline from 79% in 1992. The trend to seek greater assistance is likely reflective of the greater complexity and variety of investment choices available today.

In 2003, the number of users seeking retirement and investment planning advice grew to 89% from 85% in 2002. Since 1998, this figure has seen relatively steady growth. Advisory services related to tax (36%), insurance (23%), and estate planning (22%) are less commonly sought and have been relatively stable since 1998.[42]

The increased usage of investment management services indicates a growing market that could be leveraged if G&F can achieve credibility in this area. Unfortunately, there can be a tendency in the wealth management business to focus on attracting wealthy individuals to help them manage their wealth, rather than attracting individuals to help them create wealth. The fact that the greatest self-perceived gap in knowledge is among women and younger adults suggests that an opportunity may exist for the credit union to develop this niche. Current investment workshops offered by G&F, particularly the one designed specifically for women, have the potential to address an unmet need.

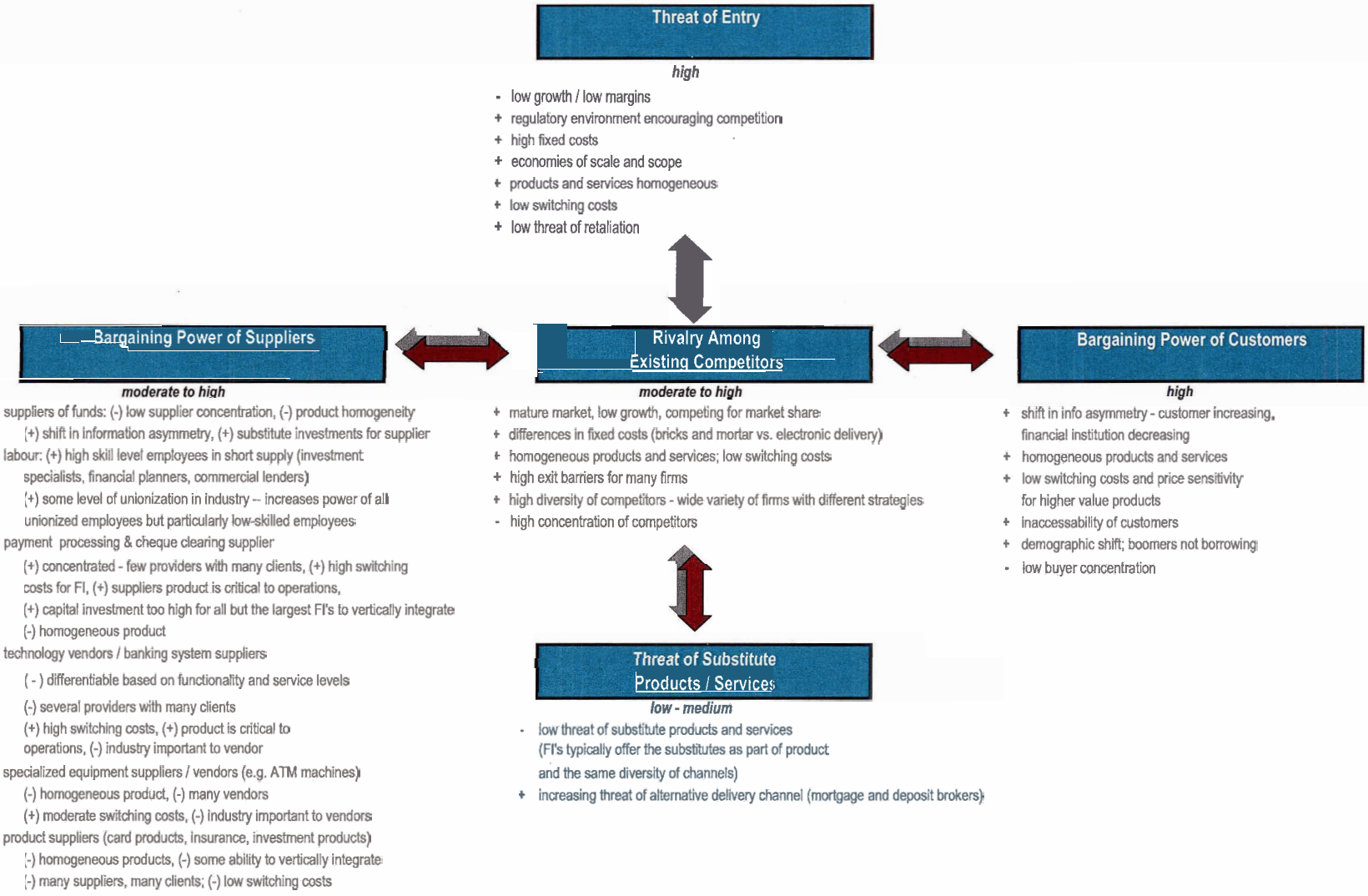
1.7 Concluding Comments

G&F offers comparable products and services as that offered by the big banks and via the same delivery channels. However, with a merged asset base of less than $650 million, G&F's share of the GVRD financial services market is minuscule. Although historically both pre-merger credit unions focussed on serving small, underserved markets, G&F's focus has strayed from targeting this group. The discussion of target markets and pricing highlight some notable differences between the target markets and the product and service strategies of ore-merger G&F and United. The demographic profile of the combined entities also highlights an aging membership, and an under-representation of younger members (15-44 year olds) and females, relative to the GVRD population overall.

The consumer research data highlighted that banks and credit unions are not meeting the expectations of consumers of financial services. With a decline in the market share across all

product categories for both credit unions and banks, consumers are satisfying their needs via alternative service providers. United's and G&F's member research indicate high levels of member satisfaction with service levels, and other research indicates that credit unions overall are perceived to be providing better service than banks. With service rated as the most important attribute by consumers in selecting a financial institution, G&F is well positioned to build on this strength. Clearly, if G&F is unable to meet the expectations of members, it runs the risk of losing its member's business and will be challenged in attracting new business.

Figure 6: Five Forces Factor Analysis – B.C. Retail Banking Industry (2004)
Source: EMBA 607 Strategy Seminar, Ed Bukszar, 2004 (Adapted with permission)



2 INDUSTRY ANALYSIS

The retail banking industry in B.C. has approximately $135 billion in assets of which almost 21% is held by credit unions; total funds on deposit (registered and non-registered) in B.C. financial institutions total approximately $115 billion with credit unions holding 22.4%.[43] In terms of number of branches of deposit taking intermediaries, there are an estimated 1224 branches in B.C. Of these, 341 are credit union branches, 877 are bank branches, and the remaining four are "trust, loan, or other."[44] For the purpose of this paper, the retail banking industry is defined as those firms that act as deposit-taking intermediaries and retail banking is a subset of the financial services industry.

In addition to providing retail banking services, some firms offer other complementary financial services such as wealth management and insurance. The ability for a retail banking institution to offer these services differs based on the regulations under which they operate (i.e. provincially or federally regulated). The primary competitors in this industry in B.C. are banks, credit unions, and trust companies. However, the retail banking industry is no longer "pure" in that competition is coming from other industries, niche players and firms using non-traditional delivery channels.

In the Greater Vancouver area, where G&F branches are located, all of the major banks and trust companies are represented, as well as six of the nine largest B.C. credit unions (G&F is tenth largest) and eleven credit unions that are smaller than G&F. Users of financial services may choose from of a variety of financial institutions with which to do business. The scope of products and services offered by banks and credit unions are comparable, except for the area of insurance where there are different regulatory restrictions placed on banks than on credit unions and for some of the smaller credit unions.

The following industry analysis is based on the "Five Forces of Competition" model developed by Michael Porter.[45] This model considers the threat of new entrants, rivalry among existing competitors, threat of substitutes, bargaining power of suppliers, and bargaining power of customers. A competitive analysis of the retail banking industry from these five perspectives highlights the challenges and opportunities that firms in this industry face.

2.1 Threat of Entry – High

2.1.1 (-) Low Growth and Low Margins

The retail banking industry is a mature industry characterized by low growth and low margins, particularly for firms operating traditional, branch delivery models. With limited

growth, a new entrant would have to steal market share from existing, long established financial institutions, focus on serving underserved markets (e.g. "picking up loose bricks" strategy), or enter with a different strategy (e.g. virtual banking) where it has reduced fixed and operating costs and, therefore, able to generate greater margins.

2.1.2 (+) Favourable Regulatory Environment

In order to encourage competition in the financial services industry, the current regulatory environment for federally regulated institutions is favourable. Foreign banks are able to set up in Canada and, due to changes in ownership laws, firms from other industries have received approval to set up national bank subsidiaries (e.g. Canadian Tire Bank, Sears Bank and President's Choice Bank). Provincially regulated institutions, such as credit unions, have not been as successful in achieving approval to set up new retail banking institutions (e.g. Formosa Credit Union, Punjabi Credit Union, and Indo-Canadian Credit Union); however, this is largely due to their size and lack of capital adequacy.

At the provincial level, there are limited restrictions preventing one regional credit union (e.g. Interior Savings) from expanding into another region (e.g. the lower mainland). In fact, on May 13, 2004, the Finance Minister introduced amendments to the *Financial Institutions Act* and the *Credit Union Incorporation Act*. The amendments would allow B.C. credit unions to operate outside of B.C. and allow non-B.C. credit unions to operate in B.C. This would increase the potential for competition within B.C. and provide opportunities for B.C. credit unions to achieve greater scale economies by expanding outside of B.C.[46]

Regulations permit banks to offer insurance services, and insurance companies can tread into retail banking territory. However, banks are only able to sell insurance products via a call centre or the internet; they are not permitted to sell insurance in a physical location. B.C.'s *Financial Institutions Act,* which governs credit unions, does not permit credit unions to sell insurance products directly through the credit union, but allows them to do so through a subsidiary. The insurance subsidiary must be "separate and distinct" from the credit union's operations and this must be clear to the public. Due to the lobbying efforts of the Insurance Brokers' Association, the credit union and the insurance agency are not permitted to share individual member information nor can the insurance agency use the credit union's member database to do targeted marketing. Other than some possible benefits from branding, the B.C. regulations ensure that credit union insurance subsidiaries do not achieve a competitive

advantage by being related to the credit union. However, the proposed amendments to the *Financial Institutions Act* and *Credit Union Incorporation Act* will:

> "Modernize the market conduct regulatory requirements imposed on financial institutions and their intermediaries, removing unnecessary restrictions on competition in financial services and products."[47]

Should these proposed amendments come into effect, credit unions could gain significant opportunities to capitalize on their existing member relationships to more aggressively promote their insurance services. However, it is likely that this opening of competition will come at a price for credit unions.

2.1.3 (+) High Fixed Costs

The traditional retail banking industry, characterized by the high cost of branch locations, is facing decreased fixed costs due to significant advances in technology – on-line banking, telephone banking, and ATM's have lead to reduced use of branches and their inherent cost (staffing, facilities operations, and real estate). With the ability to deliver almost the full range of banking products and services via technology, new entrants are able to reduce the high costs of branches and provide basic products and services more cost effectively and efficiently via technology and centralized call centres, than if they operated branch structures.

The high costs related to advertising and building a brand identity are also reduced for those that have built brand equity in another business such as retailing (e.g. Canadian Tire, Loblaws and Sears) or in a foreign market (e.g. ING and Wells Fargo). In addition, retailers that wish to enter the retail banking industry can capitalize on economies of scope by using existing retail sites to offer personal service without the high cost of branching.

It is important to note, though, that the high cost of branching can be a deterrent for a credit union in one region to expand into another region, unless it does so via mergers or alternate delivery channels, such as with broker arrangements and virtual banking (e.g. Prospera Credit Union's federally regulated virtual "Ubiquity Bank"). The most common approach for expansion is via mergers which enables a credit union to capitalize on an existing membership base and brand identity.

2.1.4 (+) Economies of Scale and Scope

Although economies of scale are a barrier for a start up or small firm to enter the banking market in the lower mainland, the reality is that large, national firms with considerable resources have the ability to enter the market nationally with sufficient scale to compete in this industry. For example, Loblaws had the capacity to set up President's Choice Financial Services "kiosks"

across Canada in its retail stores and, with online banking, achieve sufficient economies of scope and scale to offer basic retail banking products and services, and better rates than many of its competitors. Prior to the advent of online banking and ATM's, Loblaws would have been unable to serve customers profitably through only in-store kiosks. Although the minimum efficient scale is decreasing to allow for smaller scale entry into this industry, the minimum efficient scale is still prohibitive for most new entrants to break into this industry. The exception to this would be new entrants focussing on a niche (e.g. "payday" loans and mortgage brokers) or those that are able to exploit scale economies achieved in another industry (e.g. Sears Canada).

2.1.5 (+) High Product and Service Homogeneity

Retail banking products and services offered by financial institutions are perceived as homogeneous by customers. Hence, it is easier for new entrants to compete in this market, as they will not have to contend with trying to overcome customer loyalties related to differentiated products or services, although they will need to be competitive on costs.

2.1.6 (+) Low Switching Costs

Switching costs are not a significant barrier to entry for this industry, particularly if the entrant is not pursuing a full "relationship banking" model. For products and services such as savings accounts, new loans and mortgages, and credit cards, the switching costs can be extremely low. However, it is important to recognize that the increased usage by customers of automated bill payment services creates greater lock-in to a particular financial institution for the customer's everyday transactional activities. As people increasingly use automated bill payment services, their switching costs increase due to the effort required to change each pre-authorized payment that they have set up. This suggests that while it may be more difficult to capture the full banking relationship, the costs of switching on a product-by-product basis are not prohibitive to customers.

2.1.7 (+) Low threat of Retaliation

While the conditions exist in the industry that suggest a high likelihood of retaliation (e.g. established firms with commitment to the industry, considerable resources to retaliate, and slow industry growth) there has been no history of vigorous retaliation to entrants. Although this could be because those firms with the ability to retaliate do not perceive the recent run of new entrants as a threat, it is likely that the cost of retaliation, unless very targeted, is very expensive. In addition, retaliation could lead to charges of unfair price competition. Smaller financial institutions are not sufficiently strong enough to retaliate.

2.2 Rivalry among Existing Competitors – Moderate to High

2.2.1 (+) Mature Market; Low Growth

The retail banking industry is a mature industry with low growth, therefore, the focus among competitors is to "steal" market share. This leads to a high level of rivalry in the industry.

2.2.2 (+) Differences in Fixed Costs

Existing competitors, particularly full service, bricks and mortar branch models, have high fixed costs. The newer entrants, such as ING and insurance companies, are offering a narrower range of products and services, largely through their existing channels and the internet, at lower fixed costs. Because of the lower fixed costs of these competitors, they are able to offer better rates on deposit and lending products than many of the bricks and mortar retail banking firms.

2.2.3 (+) Homogeneous Products and Services / Low Switching Costs

Most customers perceive retail banking products and services as non-differentiable and, therefore, base their decisions on price. This can lead to intense price and service competition in order to attract customers. Since customers experience low switching costs on many individual products and services, they can be easily lured away from competitors, thereby potentially increasing a firm's market share, at least in the short run. Hence, there is intense competition on loan and deposit rates, particularly for larger loans and deposits.

2.2.4 (+) High Exit Barriers

For those firms competing in the lower mainland, the exit barriers are relatively low on an individual branch basis. For example, in recent years, the major banks have closed branches deemed unprofitable and then transferred the business to another nearby branch. However, for a large firm, such as a Schedule I bank, to exit out of the lower mainland, exit costs would be very high, if not prohibitive. It would be difficult for the bank to liquidate its assets as there are few firms with sufficient resources to acquire these assets, but also the bank would likely not be able to recover fixed costs if it exited the industry and therefore experience capital losses. In addition, there would be restrictions as to which firm the bank could sell its assets (competition issues if another bank) thereby making exit very difficult.

When forced to exit, smaller financial institutions, such as credit unions, will either merge or sell their assets to another credit union that is eager to expand its market share. The merger activity among B.C. credit unions in recent years suggests that while there are exit costs,

they are not prohibitive. In fact, when a smaller credit union is unable to compete effectively, it is often encouraged by the provincial regulators to seek a "merger" partner.[48]

For large firms that rely more heavily on technology as their primary delivery channel, exit out of the lower mainland would likely be tied to exit out of a larger geographic area versus a small region (e.g. ING pulls out of Canada). In that case, the exit costs are high. The exit costs for other smaller competitors (e.g. insurance companies selling deposit products, mortgage and deposit brokers, and payday loan companies) would not be as prohibitive as they are for a full service financial institution where the primary line of business is retail banking. This is in part due to a smaller capital investment in the retail banking aspects of the business as it is not the core business, or because the competitor has entered the industry on a small scale.

2.2.5 (+) Diversity of Competitors

This industry is no longer comprised of only traditional full-service retail banks. Therefore, the business models, strategies, and objectives in this industry tend to be quite diverse. For example, an insurance company that offers a demand deposit savings account in addition to its insurance products, but no other "banking" products, is not trying to get the full banking relationship, but is looking to expand its product line as part of its insurance and estate planning services. Therefore, there is greater likelihood of divergence from traditional retail bank pricing. The cost structure and business objectives of these divergent firms can drive their pricing in a direction that differs from traditional banking practice. Hence, the greater diversity among the competitors, the greater the likelihood of unpredictability of competitive behaviour.

2.2.6 (-) High Concentration of Competitors

While there are a relatively large number of competitors in the lower mainland offering a range of retail banking products and services, the five Schedule I Canadian banks (Bank of Montreal, RBC Financial Group, Scotia Bank, TD Canada Trust, and CIBC) dominate the market. CUCBC's 2003 Products and Services Study reported the market share of Schedule I and Schedule II banks in B.C. is in excess of 70% for chequing and savings accounts and 60% market share for personal loans, small business accounts, and term deposits.[49] The similarity of prices among retail banking firms illustrates low price competition, with competition focusing more on advertising and promotion. Price competition that does exist is at the individual transaction level and coming from newer entrants pursuing a different strategy (e.g. ING's virtual banking).

2.3 Threat of Substitute Products/Services – Low to Moderate

The threat of substitute products and services is low, as substitutes for traditional retail banking products and services and delivery channels are among the offerings of the full service financial institutions. That is, banks include the substitutes among their product mix.

Credit is available from almost any business a consumer chooses to do business with, and the credit products are essentially the same as those offered by retail banking institutions (e.g. loans and credit cards). Therefore, they are not substitute products, but perhaps a substitute delivery channel. In terms of savings products, there are a variety of substitutes available (e.g. savings bonds, mutual funds, annuities, securities etc); however, most retail banking firms are able to offer many of these investment options either in a branch, on-line, or via their investment subsidiaries. The threat of substitution by providing retail banking services through alternate delivery channels has also decreased as retail banking firms also offer their services via these channels – e.g. phone banking, online banking, online brokerage, ATMs and credit cards. To the degree that the retail banking firms offer the available substitutes among their product and services portfolio, they mitigate the threat of substitutes.

However, two areas of potential threat are the increasing role of mortgage brokers and payday loan companies. Brokers provide consumers an alternative to negotiating directly with a financial institution and will do the legwork (e.g. solicit bids on the business) for consumers to find the best rate in the market, or fund the mortgage through their own firm. In addition, brokers enable consumers to avoid dealing with the confusion caused by the increasing number and complexity of mortgage products on the market. If brokers make it easier for consumers to place their business with other financial institutions, bankers will lose the opportunity to meet with their customers to negotiate the business.

Although brokers may be perceived as non-threatening because they are often small, independent firms, their growth and increased usage indicates that they ought not to be underestimated as they have the potential to have a significant impact on the industry. The Canadian Institute of Mortgage Brokers and Lenders (CIMBL) reports that two years ago, only 14% of mortgages in Canada originated through a broker and in 2003, this amount had almost doubled to 26%. CIMBL predicts that within the next several years, brokers will originate 50% of all mortgage business in Canada.[50]

In response to the threat of brokers, some credit unions have taken on this role for their members. By seeking the best rate in the market for its members, the credit union is able to maintain its relationship with members and reduce the risk of losing the members' full business.

Payday loan companies are not only increasing in consumer acceptance and popularity, but they are also expanding their services to act more like full service financial institutions. The most significant of these institutions is Money Mart with nearly 300 locations across Canada, 100 million registered users, 60% market share of payday loan business, and an 18-year complaint free record with the Better Business Bureau. Contrary to popular belief, the typical Money Mart user does not fit the profile of the "disadvantaged." The typical customer is 34 years old, male, and employed with an annual income of $34,000. Research findings show people who use payday loan companies feel comfortable doing business in these places, but not in doing business with banks. In addition, people often use these services because "money was tight" and they needed payday loans for day-to-day expenses (34%) and for an emergency (23%).[51] Given that fewer people are saving money and they are poorly positioned financially to deal with emergencies, it is not surprising that these firms are growing.

While there is considerable debate and scrutiny regarding the business practices of payday loan firms (high interest rates and processing fees), they have the potential to create some competition for credit unions, which have typically focused on small, under-served markets. In addition, the services provided by Money Mart extend beyond "payday loans." It provides cheque-cashing services and, unlike banks or credit unions, there are no holds on cheques so customers have immediate access to their money. Like banks and credit unions, it offers foreign currency exchange services, bill payment processing, electronic funds transfer, and money orders. Customers may also deposit funds into their Money Mart accounts and access them via their Money Mart debit cards.[52]

2.4 Bargaining Power of Suppliers – Moderate to High

2.4.1 (-) Suppliers of Funds

To have a supply of money to lend, retail banking firms must have an incoming supply of funds in the form of deposits. In this relationship, financial institutions hold greater bargaining power due to product homogeneity, low supplier concentration, and low switching costs for financial institutions. In the past, information asymmetry decreased the power of depositors (suppliers of funds); however, with increased access to information through the internet, it is easier for depositors to source financial institutions that are willing to pay higher prices for their deposits. Depositors also have access to substitute products in which they can invest their funds. Although depositors have less power in this relationship than the financial institution, the power of depositors is increasing. However, the degree to which individual suppliers of funds have

power varies based on the amount of funds they have for deposit and the longer the term that they guarantee to keep the funds on deposit.

2.4.2 (+) Labour

Employees with specialized skills, such as investment specialists, financial planners, and commercial lenders, currently have considerable power in the employment relationship as there is a shortage in the supply of people with the skills to perform these jobs. This problem is exacerbated by the fact that commercial lending and wealth management are two key areas of business focus and revenue growth for financial institutions. Not only does this power translate into an ability of these employees to negotiate better compensation packages, they often also have the ability to switch employers relatively easily, which increases the firm's costs, creates disruption for the firm, and can result in lost customers as they follow the ex-employee to the new firm.

For those employees with lower skills and no specialization, their power is relatively low, except for those employees that are unionized. Unionized employees not only have the power to negotiate terms and conditions of employment that are superior to that received by non-unionized employees, but they also have the legal right to impose economic sanctions on an employer through strike activity. Non-union employees do not have this same level of power in the employment relationship.

2.4.3 (+) Payment Processing and Cheque Clearing Supplier

A few large companies dominate payment processing and cheque clearing services. These services include cheque processing, bill payments, and electronic funds transfers for settlement through the national clearing and settlement system. In addition to serving financial institutions, they also conduct payment processing for various other firms such as governments, health care agencies, retailers, and insurance and utility companies. Due to the high fixed costs involved with operating a clearing function, there are few suppliers with many clients, with some of the larger financial institutions operating their own, or joint, clearing centres (backward vertical integration).

Since only a few large financial institutions have the resources to backward integrate, the power of these suppliers is increased. The clearing process is critical to financial institutions and, because there are considerable switching costs, the strength of suppliers is enhanced. Although payment processing and cheque-clearing processes are governed by the Canadian Payments Association and, therefore, the services of these suppliers are homogeneous, the high

switching costs for financial institutions prevent them from taking advantage of the commoditization of these services to negotiate contracts. In this relationship, the financial institution has limited bargaining power.

2.4.4 (+) Technology Vendors / Banking System Suppliers

Adoption of a banking system is a huge investment not only in terms of the purchase price of the system, but also in terms of the costs related to system conversions, staff training, changes to business processes and customer communication. In addition, because a banking system is critical to a financial institution's operations, system stability cannot be compromised, which can be a risk with system conversions. These elements all contribute to very high switching costs for the financial institution and increase the power of the supplier.

The relative power of the financial institution and the vendor will vary considerably based on the size of the financial institution.[53] Larger financial institutions typically have more options available to them because they can afford to consider a wider range of vendors. In addition, very large financial institutions (e.g. Schedule I banks) are able to build proprietary systems or assemble a variety of tools (CRM, web banking, financial planning) from different vendors. A larger financial institution also represents a more significant proportion of the vendor's business as well, thereby increasing the financial institution's bargaining power. These factors all enhance the bargaining power of the large financial institutions.

This industry is relatively concentrated with several vendors having many clients. In addition, the number of suppliers in this area is increasing. Products and services are differentiable – some systems have basic functions, while others offer considerable functionality, service, and support levels. For example, some banking system vendors offer full customer support and maintenance services as part of a service contract whereas lower cost systems offer a basic "banking system in a box." The lower cost solutions avoid the hefty monthly support fees, but the financial institution must have in-house technical expertise to manage and maintain the system and resolve technical problems. More elaborate systems offer full technical support, and may include a wide range of bells and whistles. For example, one banking system has the ability to store photos of members such that the tellers can match an image to the person doing a transaction, and the customer's picture is displayed on the monitor of the ATM. Some systems also offer complementary banking service modules such as loans origination systems and CRM capabilities.

The financial services industry is important to vendors serving this industry as many of the vendor's products have limited application outside this industry. In addition, with the increasing number of vendors and reduced number of firms due to consolidation of the industry, the power of suppliers relative to buyers is declining.

2.4.5 (-) Specialized Equipment Suppliers and Vendors

Retail banking operations also rely on specialized equipment, such as ATMs, to deliver services. Although ATMs are an important method for delivering services to customers and, therefore, important to financial institutions, the balance of power in this relationship would lean more heavily in favour of the financial institutions. There are a large number of vendors, products are not differentiable, and the vendors are reliant on this industry. The element favouring the vendor is the fact that there are moderate to high switching costs to change vendors. Because of these characteristics, the relative bargaining power of these suppliers is low and enables financial institutions to negotiate better or stable pricing.

2.4.6 (-) Product Suppliers

Product suppliers have low bargaining power, particularly in dealing with larger financial institutions. Financial institutions offer a wide variety of products that they acquire from a variety of suppliers – credit cards, mutual funds, and insurance (for mortgages and loans as well as property and casualty). Except for credit cards, the products offered by these vendors are largely homogeneous, there are many vendors in most of these categories (low concentration of suppliers), and low switching costs. As with other supplier relationships discussed earlier, smaller financial institutions will have less bargaining power in the relationship than larger financial institutions simply because their business will be a smaller proportion of the supplier's total business.

2.5 Bargaining Power of Customers -- High

2.5.1 (+) Shift in Information Asymmetry

Several events are enabling a shift in information asymmetry thereby increasing the power of customers, and decreasing the power of firms in this industry. In addition to the fact that consumers are more knowledgeable and more sophisticated about financial matters than ten years ago, the internet has further facilitated decreasing information asymmetry. The internet has significantly reduced customers' search costs as providers of retail banking products and services not only provide information on the features and benefits of their offerings, but also publish their

fees on the internet. Comparison-shopping has never been easier. Another factor leading to a shift in the information asymmetry is that of recent privacy legislation. This legislation restricts the firm's ability to use customers' personal information for marketing and sales purposes. The availability of mortgage brokers who will gather bids on a customer's business also enhances the customer's access to information.

2.5.2 (+) Homogeneous Products and Services

Products and services in the retail banking industry are highly homogeneous and have become commoditized. As a result, consumers are largely indifferent between financial institutions and are able to play one against the other to negotiate better rates and terms, particularly for larger transactions (e.g. mortgages) or larger books of business (e.g. the full banking relationship). In addition, there exists an increasing selection of alternatives available to customers to meet their varied financial needs. These factors shift the balance of power to the customer.

2.5.3 (+) Low Switching Costs and Price Sensitivity

The cost related to switching on a product basis is generally very low and, therefore, customers can shop the market for the best price. However, the propensity to switch is greater if the price advantage represents a greater proportion of the customer's total income. For example, it is less likely that customers will switch financial institutions to save twenty-five cents on ATM transactions if they are a low user of ATMs, than if they can save .25% interest on a $400,000 mortgage.

To create lock-in, financial institutions build switching costs into the design of their products. For example, a customer may experience an early payment penalty on a loan when the customer attempts to transfer the mortgage to another financial institution. However, many competitors will pick up the switching costs for customers who transfer in their business (e.g. waive the fees for transferring RRSPs, provide low cost legal fees for mortgages or set up a new customer's automated payments for their new account).

To the degree that switching fees (financial and non-financial) are low for many high value products such as loans and deposits, particularly for new loans and deposits, customers can easily move this business from one competitor to another. For example, ING makes it very easy for customers to set up accounts over the internet and transfer funds to their ING accounts from other financial institutions.

2.5.4 (+) Inaccessibility of Customers

With their increasing success in getting their customers to reduce usage of branch services and adopt technology, financial institutions have lost the opportunity to market their products and services on an individual customer basis. The richness of information that comes with member contact and through the development of relationships with people, versus PINs, has been lost. Without this personal interaction, the financial institution must exert greater effort in order to identify opportunities to match products and services to customer needs. Customers have greater power as they will seek out information when it suits them, versus being subjected to a "sales pitch" each time they visit a branch.

2.5.5 (+) Demographic Shift

The baby boom bulge has moved to the stage of their lives when they are no longer borrowing, but more focused on growing their wealth for retirement. The retail banking industry has traditionally relied primarily on profits generated through the spread between deposit and loan rates. With fewer borrowers, customers in need of lending services (e.g. young adults) have greater bargaining power as financial institutions scramble to get a share of this market. This group of potential borrowers is also particularly important as a high level of deposits from the baby boomers must match a high level of lending in order to generate profits.

With this shift in demographics, financial institutions have become more reliant on fee revenue such as from trailer and brokerage fees on investment products. Rather than lose the boomers' deposits completely, financial institutions have responded by offering substitute products such as mutual funds and equities.

2.5.6 (-) Buyer Concentration

The lack of buyer concentration in this industry reduces the power of buyers. In this industry there are many individuals purchasing banking product and services, with each individual comprising a small portion of a firm's total business. Of course, this also suggests that buyers may have greater influence when dealing with smaller financial institutions than when dealing with larger ones, particularly if an individual has a large book of business. The lack of buyer concentration tends to result in higher prices and levels of profitability.

2.6 Industry Attractiveness

Overall, this industry is not very attractive if we consider it from a traditional, full service retail banking perspective. This industry analysis suggests that this industry is likely to be characterized by low profitability. There is high threat of entry, particularly by other industry

sectors (insurance and retail) and foreign competitors, which are able to overcome many of the entry barriers – capital investment, distribution, and regulatory. They also have the capacity to change the nature of this market and decrease margins even further with their lower cost structures derived through their lower cost and more efficient channels (e.g. the internet and existing retail outlets).

To the degree that the products and services are perceived as homogeneous, switching costs are low, and competitive information is increasingly available, consumers are likely to be responsive to the new delivery models and forego loyalty to their financial institutions in order to get the best rates possible. However, although these factors increase the power of customers relative to the firm and have potential to erode a firm's market share and profitability, the low buyer concentration suggests that the magnitude of this power is influenced by the size of the customer's business portfolio relative to the size of the firm.

Although the rivalry among existing competitors has focussed on advertising and promotion, versus price, the new breed of players in this market, with their lower cost delivery models, has the ability to undercut prices (as evidenced by ING and others). Rivalry among existing competitors has the potential to grow into intense price competition and, of course, erode profitability for the retail banking industry.

The threat of substitute products and services is low because firms in the retail banking industry include many of the available substitutes among their product mix. However, adaptation of a firm's products and services to combat the threat of substitutes can increase a firm's costs due to product development and training of staff on the new offerings. There is also the danger of moving away from core competencies when a firm adopts new products or lines of business.

In terms of bargaining power of suppliers, the bargaining power of labour can be significant, particularly for unionized firms. With the cost of salaries and benefits averaging almost 50% of total non-financial expenses in this industry, a firm's lack of power in this relationship can be costly. For non-union firms, the fact that there is a lack of supplier concentration (i.e. employees negotiate their own deal at time of hire) the employer has greater power in this relationship to not only control costs, but to sever "supplier" relationships. However, unionized firms do not have this same level of power. Because the union is the sole bargaining agent for employees, the employer must negotiate the price of labour with the bargaining unit. In addition, in a unionized environment it is more difficult for the employer to sever the employment or "supplier" relationship.

To combat some of the cost of using labour in this industry, firms are increasingly able to provide services using technology, rather than labour. The greater the available substitutes for labour by using technology-based delivery channels, the less power that labour has in this relationship. Therefore, the power of labour affects the attractiveness of this industry if a firm plans to enter with a labour intensive business model (i.e. bricks and mortar) more so than if the firm enters with a model that is more reliant on technology. The threat of unionization may also be a deterrent to entry in this industry in B.C. given the unpredictable labour and political climate in this province.

The bargaining power of suppliers of technology and payment processing services reduces the attractiveness of this industry. Much of the strength in the bargaining power of suppliers is driven by firm size of the buyer, or buyer concentration. Larger financial institutions have more options that they can feasibly consider and their high fixed costs are spread over greater volumes of business. There are fewer affordable options available for smaller financial institutions and it is probable that the functionality and effectiveness of lower cost technology solutions will not deliver the level of efficiency necessary to compete in this industry. Therefore, while suppliers in this industry can exert considerable power, the relative power of the buyer and supplier will determine a firm's assessment of industry attractiveness.

The retail banking industry clearly has the potential to be profitable for a firm that enters the industry using a different business model, whether that model is virtual banking, serving under represented markets, or exploiting existing brand loyalty and distribution channels. The ability for a firm to enter using a lower cost business model, in fact, could make this industry attractive to some.

2.7 Key Success Factors

The preceding industry analysis provides us with some insights to help us identify how retail banking firms can compete in this industry. Clearly, price competition and commoditization of retail banking products and services make survival more challenging for firms in this industry, particularly for small, full service retail banking firms such as credit unions. Because large banks have low cost operating structures, they do not have the same need as credit unions to differentiate their products and services. Therefore, to survive in this industry, credit unions must be able to differentiate their products and services in a manner that is of value to customers, and improve their operating efficiency.

Although financial services products can be modified to differentiate one firm's products from that of another firm's products, most products and delivery channels are easily imitated and, therefore, do not provide long term, sustainable, competitive advantages. To the degree that a bricks and mortar delivery channel exists, and it is costly to operate, this delivery channel needs to be exploited to create differentiation and value. Given that the products are commodities, service quality and the "customer experience" can be used as a basis for differentiation. If this high cost channel does not enable a firm to differentiate itself from its competitors, it is questionable as to whether this channel is providing value to the firm, or sucking value from it.

While some of the shifting of business to new competitors is due to price differentials, some of this business is shifting because of existing gaps in service levels among banks and credit unions. The consumer research consistently reports that credit unions outperform other financial institutions with regard to service quality. However, with increased use of technology-based service channels, there is less opportunity for credit unions to demonstrate that not only are their rates competitive, but that they provide superior service. It is important to remember that the majority of consumers still want convenient access to physical branches and they want high levels of service from knowledgeable staff. Although firms are making considerable headway by leveraging technology to get a share of this market, there is still a strong demand for bricks and mortar operations.

New entrants using lower cost business models have the ability to drive down prices reducing margins for incumbents. In order to compete effectively on product pricing, retail banking firms must manage and improve their operating efficiency. With advances in technology, considerable opportunities exist to achieve efficiencies by migrating mundane business activities to electronic service delivery. Firm size is important to not only achieve scale efficiency, but also is an important factor in the firm's ability to exercise greater power in supplier relationships, and ability to consider vertical integration on some of its core business processes.

Clearly, the two most important factors for success in this industry are service delivery and leveraging of technology. Firms using a bricks and mortar delivery channel need to develop and maintain highly knowledgeable and skilled service staff. This not only requires an ability to attract and retain high performing employees, but also requires the mechanisms to support ongoing knowledge and skill development of employees. Firms will also need to develop their skills in understanding and responding to the needs of consumers. Firms that are best able to understand the needs and behaviours of consumers, and then adapt to meet these needs, have a

greater opportunity to differentiate themselves from other firms and attain a competitive advantage. This includes continuously improving products, services, and delivery channels to respond to consumer needs and desires. By excelling in service delivery, firms should be able to increase their revenue and market share.

Leveraging of technology is important in order to reduce unit transaction costs and to improve service delivery. Automation of labour intensive, mundane activities reduces unit transaction costs and enables staff to focus on activities that deliver value to the customer. In addition, automation generally results in improved service delivery resulting from faster turnarounds on activities such as loan application processing. Due to the high cost of technology, a firm's ability to achieve economies of scale is often limited by the degree to which it has the financial resources to invest in technology, and its ability to hire the skills necessary to support and enhance technology. To leverage technology effectively, firms require highly skilled human assets that have the ability to identify opportunities to exploit technology, and have the skills necessary to introduce new systems with minimal disruption to the firm.

2.8 Challenges for Credit Unions

These industry dynamics create some interesting challenges for credit unions. Clearly, the increased consolidation of the credit union system in B.C. has enabled many credit unions to improve their operating efficiency, offer competitive rates, and improve their bottom line. Although credit unions are not as profit-motivated as are banks, they need to generate sufficient levels of profitability in order to invest in technology and new service offerings to maintain, if not increase, their share of wallet and overall market share. As full-service financial institutions, credit unions are unlikely to achieve sufficient scale to compete effectively as low cost producers. To the degree that credit unions can exploit their branch delivery channels to differentiate their services from each other, there is considerable opportunity to be successful with a bricks and mortar model. The healthy competition that exists between credit unions ensures that differentiation will be one of the most significant challenges for credit unions as each credit union attempts to differentiate itself from the others.

3 INTERNAL ANALYSIS

3.1 Organization Structure

3.1.1 Corporate Governance Structure

Credit union Boards are comprised of volunteer directors elected from the credit union membership. Directors serve a three-year term. The Board of Directors of the newly merged G&F has sixteen directors, eight from United's Board and eight from G&F's Board. This Board will serve for a two-year period. In 2006, the Board will drop to fifteen members, and drop to twelve in 2007. The make up of the Board of each of these two credit unions prior to the merger varied considerably in terms of demographic makeup. G&F had an all male Board, with many from the fishing industry. United had five females on its twelve-member Board representing a variety of backgrounds. The Board Chair is the previous Chair of G&F and United's Chair is now the Vice-Chair.

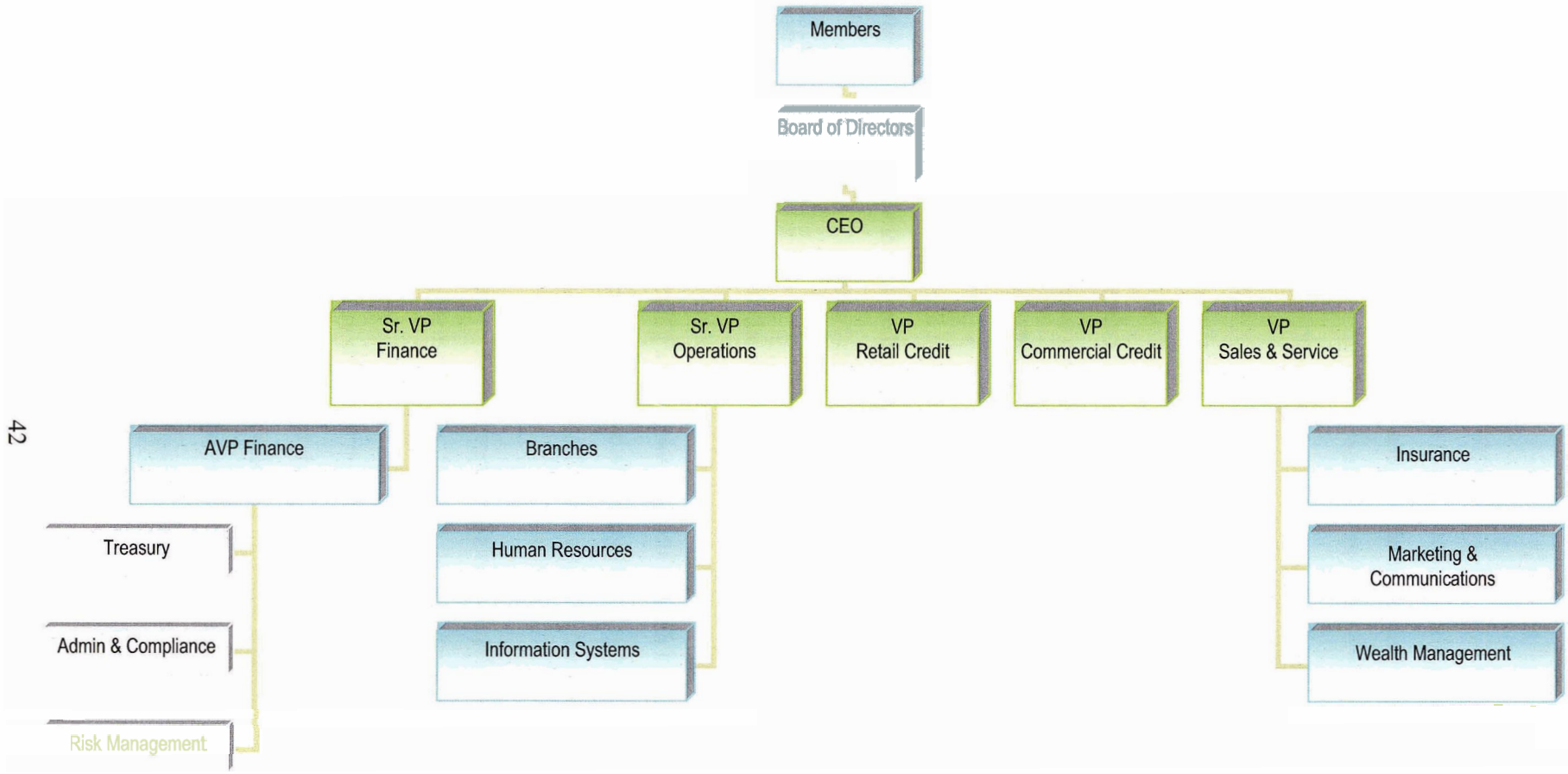
3.1.2 Organizational and Management Structure

G&F Financial Group is comprised of three subsidiaries – Gulf and Fraser Fishermen's Credit Union (retail banking), Gulf and Fraser Insurance Services Ltd. (insurance services and wealth management), and Gulf and Fraser Holdings Ltd. Gulf and Fraser Insurance Services Ltd. is a subsidiary of the credit union.

As illustrated in Figure 7, the organization is structured based on functional responsibilities – finance, operations, credit (personal and commercial), sales and service. There are six executive managers, five of whom report directly to the CEO, and one that reports to the Senior VP, Finance. The CEO reports to the Board of Directors.

The majority of employees work in branch operations serving members. Of the 160 employees, all but a few are full-time employees. Wages and benefits for all employees of G&F tend to be above the median of B.C. credit unions with wages for non-management staff being among the top quartile of B.C. credit unions. Of the twelve branches, six are unionized and represented by the Office and Professional Employees International Union. The unionized branches were acquired during the various mergers and there has not been any indication of union organizing activity of the non-union branches in many years.

Figure 7: G&F Financial Group Management Structure (May 2004)



3.2 The Generic Strategy and Strategic Fit

The generic strategy of G&F is to attempt to differentiate itself from other financial institutions through high quality service delivery and by offering a competitive range of products at competitive prices. The following explores the strategic fit, value chain and financial position of G&F and United from a pre-merger perspective.

3.2.1 The Product Strategy

G&F's product strategy is primarily that of a follower rather than an innovator. B.C. credit unions, particularly small and medium sized credit unions, adopt the new products and service offerings developed by the trade association, Credit Union Central of B.C. (CUCBC), which usually take off on developments made by the larger credit unions (e.g. web banking, telephone banking, and wealth management). Therefore, by the time these products and services are within reach of the small and medium-sized credit unions, they are not new and innovative as banks and large credit unions will have had these among their offerings for a considerable period. G&F, however, was among the first credit unions to adopt wealth management services.

In developing new variations of existing products, United considered itself innovative. Although a new mortgage or deposit product may be "innovative," it is questionable whether consumers understand and appreciate the features and benefits of "innovative" products, or whether they find them confusing and the increased selection overwhelming. The intangible nature of financial products (e.g. lending and deposit products) is such that competitors can easily imitate them and, therefore, any competitive advantage that may be achieved with a differentiated product is likely not sustainable. G&F indicated that it tended to do very little product development.

By adapting the generic new product and service offerings developed by CUCBC, United and G&F are unable to differentiate their offerings, but gain the advantage of lower costs than if they were to develop these product and service offerings on their own. (For example, the websites for most credit unions are very similar in that CUCBC develops the core of most credit union websites as part of the web banking services that CUCBC offers.) Even with the merger, it is unlikely that G&F will have the resources to develop entirely new and innovative products and services, and will still need to adopt and adapt new products developed by CUCBC. Due to economies of scale and increased resources, financial and human, the merged entity should be able to adopt new products more quickly than either of these credit unions could in the past.

In terms of strategic fit, the product strategy of each of these two credit unions has clearly leaned toward a cost-based strategy, rather than differentiation. This is simply due to affordability rather than an attempt to be low cost providers. This approach is not likely to change significantly, if at all. To the degree that G&F is cognizant of costs, it is able to offer competitive products at competitive prices. Hence, there is some degree of strategic fit.

Figure 8: Strategic Fit Chart

Source: EMBA 607 Strategy Seminar, Ed Bukszar, 2004 (Adapted with permission)

Generic Strategy : *Differentiation by offering high quality services and diverse product offerings to meet the needs of members at competitive prices.*

The black "X" indicates current position, and the arrows to the red "X" indicate some transitioning based on current activities.		**Cost Based** Low Cost / Adequate Quality									**Differentiation** High Quality / Adequate Cost	
		1	2	3	4	5	6	7	8	9	10	
Product Strategy	*Slow follower*			X →	X							*Innovative*
R&D Expenses	*Low R&D*		X →	X								*High R&D*
Service Strategy	*Slow Follower*				X →	X						*Innovative*
Employee Development & Training Expenses	*Low Investment*			X →	X							*High Investment*
Structure	*Centralized*		X									*Decentralized*
Decision-making	*Less Autonomy*					X →	X					*Autonomy*
Operations	*Economies of Scale*			X ←	X →	X						*Economies of Scope / Flexible*
Labour	*Mass Volume / Order Processors*				X →	X						*Skilled / Specialized / Flexible*
Marketing	*Comparative / Push*				X							*High Cost / Pioneering / Pull*
Risk Profile	*Low Risk*		X									*High Risk*
Capital Structure	*Leveraged*							X				*Conservative*

3.2.2 R & D Expenses

As with product development, CUCBC carries out significant research and development projects on behalf of B.C. credit unions. Annual dues paid by credit unions to CUCBC fund the expenses for these R&D activities. In the past, G&F and United credit unions conducted some of their own research, but the focus was primarily on analyzing member usage and statistics, and modifying existing products to meet changing needs of members. Both credit unions complemented internal research with generic research conducted by CUCBC or published by other consumer research firms. Unlike physical products, traditional financial service products are primarily a specified combination and quantity of services for fees, and often require limited investment to develop. Therefore, the spending on both research and development is limited. The limited internal spending on R&D and some reliance on the generic research and development conducted by CUCBC illustrates a cost-based focus, but only to the degree that it enables G&F to stay in the game, versus excel in it.

3.2.3 Service Strategy

G&F aims to differentiate itself from other financial institutions based on personalized service, relationships, and access to services (e.g. number and location of branches and access to technology based banking). Despite this desire, G&F's innovation in this area is low and, at best, it is a slow follower in proactively developing a service strategy. The level and quality of branch service is high and members generally rate the banking experience very positively. However, the service levels do not significantly differentiate G&F from other financial institutions, especially other credit unions. Jobs are structured similar to other financial institutions, and staff qualifications and skills are on par with the average of the market. However, due to low staff turnover and small branch size, staff can develop a higher level of intimacy with members than can be developed in large branches characteristic of many other financial institutions.

Prior to the merger, both United and G&F conducted member satisfaction surveys. For both, the results indicated very high levels of member satisfaction, particularly with the "service and offering" and "in-branch experience." Despite members' positive ratings on the friendliness of staff, the results of both credit unions indicate that they face some gaps with meeting the service expectations of their members. Accessibility to branches, including branch locations and hours of operation, was one of the most commonly referenced "areas for improvement" among both G&F and United members.[54] One of the key benefits of the merger for members is access to

more branches. In addition, G&F is opening three new branches in 2004, one of which will replace two existing branches that are in close proximity to each other. Figure 9 below indicates the location of the G&F branches.

Figure 9: G&F and United Branch Locations[55]

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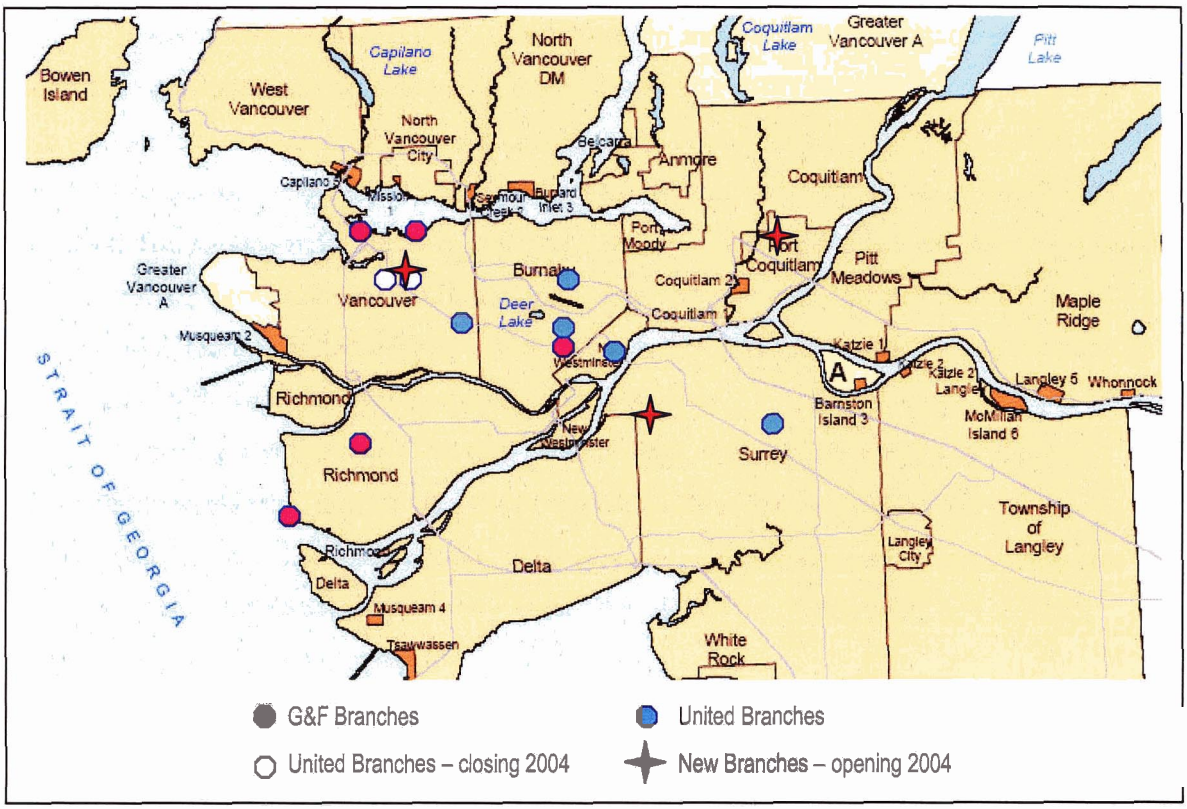


Two of the twelve branches are former Elco (B.C. Hydro) branches and are located in B.C. Hydro buildings in Burnaby and downtown Vancouver. Their business hours parallel Hydro's business hours – Monday to Friday, 9:00 to 4:30. The Dairy Industry branch located near the Dairyland plant in North Burnaby is open Monday to Friday, 9:00 to 5:00. All other branches are open Tuesday to Saturday with some branches open until 1:00 on Saturdays, and others open until 3:00 or 3:30 on Saturdays. Relative to other financial institutions, G&F's hours of operation are more restrictive, particularly compared to the larger credit unions against which G&F competes for business.

The member satisfaction ratings for each branch suggest some inconsistencies in service levels between branches, particularly among United's branches. With the number of credit

unions that have come together in recent years to form United and now G&F, it appears that consistency of service levels has suffered. Reducing the variability in service levels (i.e. eliminating the number of bad experiences, versus offsetting them with exceptional experiences) is important for G&F to differentiate itself effectively from other financial institutions. The creation of a VP, Sales and Service indicates a desire to develop a sales and service strategy and improve performance in this area.

In terms of strategic fit, G&F's current level of performance in its service strategy has not differentiated it from competitors. Although the service may be marginally better than that offered by banks, relative to other credit unions, the level of service is largely non-differentiable as credit unions as a whole strive to differentiate themselves from other financial institutions based on their service and member relationship. However, the larger credit unions against which G&F competes have progressive staff training and service programs. Relative to these larger credit unions, G&F may find its current service levels barely keeping pace with the competition, particularly with respect to staff knowledge and skill levels.

The merger will enable G&F to close some gaps in its service strategy by improving accessibility to branches and ATMs, but current initiatives to improve access will only differentiate it from other smaller financial institutions. A key challenge that G&F faces is developing and implementing a service standard throughout the organization, and ensuring consistent adherence to the standard.

3.2.4 Human Resources and Employee Development and Training Expenditures

Given the service orientation of the financial services industry, investment in staff training and development is a key component to enhancing service delivery. Clearly, people that are not knowledgeable about the credit union's products and services, that are not "service oriented," and not efficient, are unable to deliver adequate, let alone high quality service to members on a consistent basis. From a broader human resources perspective, staff that are inspired, committed and engaged can have a significant effect on how members "experience" their interactions with the credit union.

The previous CEO of United considered training to have little, if any, value. The philosophy was that "people are hired with the skills to do the job, and therefore we don't need to train them." Since the change in leadership when United and Burnaby Savings merged, there has been an increase in expenditures on employee development and training. Initially, employee training tended to be more reactive, often focussing on "product training" with the release of new

products or changes in regulatory requirements (e.g. money laundering legislation). However, in the past two years, United has increased its training in the areas of sales and service, management effectiveness, and management coaching. Unfortunately, the allocation of resources to support on-going skills development and learning has been insufficient to change employee behaviours and develop staff skills. Although training expenditures were increasing, the expenditures simply enabled United to ensure that staff kept pace with basic levels of knowledge to perform the work well, but not outstanding.

G&F's track record regarding training expenditures follows a pattern opposite to that of United. In the mid to late 1990's, a considerable amount of effort and funds were spent on staff training. In recent years, though, virtually no training has occurred. In the mid to late 1990's, G&F had a Manager, Human Resources who left G&F and was never replaced. Interestingly, G&F has a "training trust fund" of $388,000 to support employee education and learning.

United and G&F each had one individual, with a focus on administrative functions and activities, carrying out human resources activities. With limited resources, little time was available to establish innovative human resources programs that would enhance service quality. Fortunately, each of the management team's high level of staff contact and communications facilitated positive employee relations and commitment that is important during times of change. However, this is insufficient to develop employees' skills and build a sustainable competitive advantage.

Up until the merger, both credit unions' efforts in human resources and employee development was limiting their ability to exploit any potential to differentiate on service. Because each credit union was weak in its human resources competency, G&F hired a new Manager of Human Resources on May 1st to strengthen this area of the organization. However, with the volume of human resources activities related to merger integration, there are still insufficient resources and skills in the human resources area to effectively develop and implement a human resources strategy. An effectively designed and executed HR strategy is necessary for G&F to differentiate itself from its competitors. The creation of a VP Sales and Service should create a new focus on improving the credit union's service competency.

3.2.5 Structure

Although both credit unions had centralized many of their processes, under the merged entity the intent is to centralize mundane functions, such as loans processing, so that branches can focus on member services and branch operations. Branches focus on day-to-day banking

operations. Senior management at the head office deals with non-routine business issues and set the strategic direction and policy for the credit union.

Branch managers generally do not have the authority to change significantly their business operations and activities; however, they do have the freedom to communicate and promote products and services in a way that best meets the needs of their members and community (e.g. based on neighbourhood ethnicity). Other than the two branches with the insurance/wealth management subsidiary, all branches conduct the same business (retail banking). The level of centralization is not significantly different from similarly sized financial institutions that have branches and an administration office in close proximity to one another. However, larger institutions that have numerous or large subsidiaries tend to have more decentralized structures with each subsidiary operating separate from the larger parent (e.g. Scotia Macleod investments and Scotiabank).

The current centralized structure presently works for G&F because of its moderate size, and the fact that the subsidiary complements the retail banking services provided to members, rather than operating as a stand-alone business. In terms of strategic fit, the centralized structure has the potential to create an advantage. The centralization could enable the credit union to more effectively bundle wealth management and retail banking services and create seamless delivery to members. For example, the decentralized structure of banks has hampered them from creating seamless delivery of wealth management services to their retail banking customers. In addition, to the degree that centralization enables G&F's branches to focus on developing a competency in member service and not be distracted with mundane administrative processing activities, centralization enhances strategic fit.

3.2.6 Decision-Making

Credit union policies and procedures guide decision-making, and managers are expected to manage their operation as though it is their own business. Rather than elevating decisions to head office, the goal is for managers to have the expertise to make sound decisions and, ultimately, better serve members. Pre-merger G&F only tracked corporate results; therefore, individual managers did not have the same level of accountability for their results as they do now. Without data regarding their operations, it would have been difficult for managers to make informed decisions. With the increased size and complexity of operations, and emphasis on individual accountability, there is no doubt that the level of autonomy in decision-making is

expected to increase, at least in some areas. However, despite the intent to increase autonomy, authorized lending limits for G&F branches have decreased since the merger.

Overall, managers' autonomy in making decisions is not significantly different from that of similarly sized competitors. It is expected that staff will be given increased autonomy as well, but this culture shift will likely take longer to occur due to the entitlement mentality of many staff.

Unlike larger and geographically dispersed financial institutions (e.g. banks), the level of autonomy at this credit union improves the timeliness of decision-making and enhances member service. For example, a branch manager in a large national bank may need approval from a higher authority and have to jump through more hurdles, or wait for approval from someone in another time zone. This can affect customer service levels. The relatively easy access to decision makers at G&F is a service advantage relative to banks, but not relative to other credit unions. The decision-making processes do enable G&F to differentiate itself from some competitors and, therefore, increased autonomy in decision-making does contribute to strategic fit.

3.2.7 Operations

The CEO of G&F has increased the growth of his credit union by leading it through a number of mergers. The rationale for the mergers is to increase operating efficiency through economies of scale. Not only will economies of scale enable G&F to keep its pricing competitive, it could generate increased profits. For example, many costs, such as technology costs, do not grow in proportion to the size of the credit union. The increase in profits provides G&F with financial resources to invest in activities that will enable it to differentiate itself (e.g. R&D, product development, enhanced service delivery, etc). In addition, the increased size of the organization enables the credit union to move from generalist roles, where managers and executives wore many hats, to more specialist roles. By developing in-house expertise, the credit union can decrease its reliance and the related costs of external service providers.

In addition to increasing economies of scale, G&F currently has considerable scope and flexibility as the management teams of both organizations have had to develop skills and knowledge of many areas of the business. Current merger activities to achieve greater economies of scale suggest a solid strategic fit on this category.

3.2.8 Labour

In this industry, labour is largely differentiated based on whether staffs' primary function is to process transactions or provide value-added advisory services to members. This is an area that the credit union recognizes the need for highly skilled and knowledgeable staff in order to serve more educated and sophisticated consumers. In addition, the diversity of wealth management products and services requires increased skills and training than that required in the traditional banking environment. Despite efforts to upgrade the skills and knowledge of staff through a variety of training programs, there are pockets of resistance to upgrading of skills. Due to a lack of investment and focus on human resources related activities, it is not surprising that there are some challenges with consistency of service levels and that neither credit union has been able to achieve a level of service quality superior to its competitors. However, the addition of a new Human Resources Manager and creation of a VP Sales & Service are positive steps to achieving strategic fit in this dimension.

In terms of management skills, due to the credit union's size, the management structure has been such that managers had to be strong generalists, rather than experts in a particular field. With the increased size of the credit union, there will be more emphasis on developing specialists, particularly at senior levels in the organization. This variable is very important for this credit union to implement its strategy to differentiate itself from its competitors.

3.2.9 Marketing

United and G&F used a combination of push and pull strategies in their marketing. Although there is a desire by the executive and management that employees are more assertive in identifying and pursuing opportunities to refer, up-sell or cross-sell products and services, the adoption of this approach has been slow and, as a result, the push strategy has been weak, but stronger among the G&F branches.

United's marketing initiatives focussed on a pull strategy whereby brochures, mail drops or participation in community events have served to generate awareness of the credit union and its product and service offerings. Both credit unions have advertised in local community papers to promote specific campaigns, with G&F running ads more frequently. To promote its wealth management services, G&F has also sponsored events with B.C. Business magazine. There is limited use of external resources in carrying out marketing activities and in the development of marketing materials. The internet banking sites also use a pull strategy to create awareness of offerings and increase demand for products and services.

When G&F decided to develop its wealth management business, it changed its trade name from Gulf and Fraser Fishermen's Credit Union to G&F Financial Group. In addition to the research and renaming costs, G&F has targeted its marketing in building the G&F brand and its wealth management services. With the last several years filled with merger activity, United's focus has been on member communications and integration of products and services, not on building brand equity.

CUCBC's province-wide advertising campaign complements individual credit union marketing initiatives. The province-wide advertising campaign, conducted on behalf of all B.C. credit unions (i.e. "people before profits," and the "i-switch" campaigns) also follows a pull strategy. The goal of the province-wide advertising is to create awareness of credit unions' "people philosophy" and of the products and services offered by credit unions. From time-to-time, both United and G&F use some of the promotional materials prepared by CUCBC to tie into the province-wide campaign, but use it primarily as "filler" between campaigns. Both credit unions attributed little direct benefit from the province-wide campaigns. The province-wide advertising does aim to differentiate credit unions from banks based on service. However, it does not enable an individual credit union to differentiate itself from other credit unions.

The strategy of both of these credit unions is aligned with a cost-based strategy, but more strongly so for United than G&F, which has been investing more heavily in its marketing to develop brand equity and credibility in the wealth management business. With the limited resources of each of these credit unions, neither has achieved considerable success in developing brand equity nor in developing their markets. However, G&F is making some progress in building its wealth management business beyond existing members, but it attributes this growth primarily to word-of-mouth advertising.

The intent is that the combined marketing resources of the two credit unions will be sufficient to create brand equity and awareness of the range of financial services it offers, and its expertise in providing financial planning advice. At the same time, the mandate of the sales and service division is to develop a stronger sales culture – a clear push strategy. The marketing strategy seems to be pulling in the direction of both a cost-based strategy and differentiation strategy. In general, marketing is an area where there appears to be a mix of conflicting strategies occurring and, therefore, limited strategic fit. However, the more disconcerting issue is that marketing has a rather insignificant role in these two organizations and lacks strategic focus.

3.2.10 Risk Profile

To mitigate risk, the financial services industry is highly regulated and monitored. However, despite these regulatory controls, some financial institutions do run their liquidity much closer to their regulatory limits than that of other financial institutions. Liquidity represents the portion of deposits held in liquid assets, and the financial institution's ability to meet current demands for funds such as withdrawals, loans and its own short-term debt obligations. Based on their liquidity, both United and G&F have a low risk profile. At the end of 2003, United's liquidity was 20.4% and G&F's was 21.9%. This is well above the regulatory requirement of 10% liquidity and above the B.C. credit union system average of 12.3%.

United's rapid growth, and now G&F (as tracked by the current CEO's history) has been achieved by carefully selecting merger partners, unlike the rapid growth achieved by other credit unions through building their lending portfolio. Pursuing growth through increased lending often results in taking on riskier loans, rate discounting and running liquidity down to statutory minimums. In the past, to deter risk-taking behaviours that could compromise the credit union's financial position, United's Board set performance criteria for the CEO, and the CEO's compensation was tied to performance relative to this criteria. The risk profile of G&F was also low.

At present, the low risk approach for this credit union, contributes to its strategic fit; however, in the longer term as it continues to grow, its low risk approach may impede its ability to compete effectively with larger financial institutions and to gain market share.

3.2.11 Capital Structure

Both credit unions have no debt, other than that related to operations (i.e. member funds held on deposit). As a co-operative, credit unions do not have access to the capital markets and, therefore, must raise capital from their membership through a token purchase of membership shares. The remaining capital is retained earnings. As with liquidity, there is a minimum regulatory limit for capital adequacy, which is 8% of the total value of risk-weighted assets. G&F's capital adequacy at the end of 2003 was 14.1%, United's was 13.0% and the B.C. credit union system average was 12%. The capital structure, although not significantly different from most credit unions, is considerably more conservative than that of the banks, which use long-term debt or issue shares to fund their operations. The high capital adequacy of G&F and United not only provides considerable strength to finance growth and expansion of services, it also enables the credit union to pursue larger commercial portfolios. This conservative capital structure does provide strategic fit.

3.3 Organizational Culture

Like most credit unions, both G&F and United are highly member focused and committed to supporting the communities in which they are located. However, the member focus manifests itself differently in these two credit unions. For example, to support its promotion activities, United owned a tent, popcorn machine, and candyfloss machine; G&F owned an indoor display booth and a wide variety of golf paraphernalia (e.g. balls, vests, shirts and golf tools). G&F's promotions and community support was more adult-oriented whereas United's was more family-oriented. In terms of the communities that they represent, G&F focused its support on the fishing community and Hydro employees, even though many of its members have no affiliation with either of these industries. United has tended to take a broader approach in that it provides considerable support to the communities in which it operates with staff actively involved in community events. This difference is evident in their marketing activities and business focus. Where United would spend $500 to buy 500 one-dollar pens, G&F would buy 50 ten-dollar pens -- clearly, quite different philosophies. Pre-merger, these cultures may have provided some level of strategic fit for their respective organizations, but together they create an interesting mix that is odds with each other, and that of the merged entity. For example, United's inexpensive give-aways support a cost-based approach whereas G&F's costly give-aways lean toward a differentiation strategy.

In many of the G&F branches, there is a "sense of family" among the employees. Its culture is somewhat paternalistic and there tends to be an "entitlement mentality" among many employees. Other employees, however, want greater challenges, setting of goals, and desire rewards tied to performance. Although G&F had a desire to be growth-oriented, in recent years the follow through on this objective was inconsistent. Decision-making was a very inclusive process with some suggestion that the consultative process at times slowed down decision-making.

United acknowledges the existence of a paternalistic culture in the past; however, in recent years, the shift has been to increased accountability, and greater emphasis on results and teamwork. Since joining with Burnaby Savings, the focus of United has been on growth, managing costs and building a strong and high performing team. While traces of entitlement still exist among some employees, the majority of employees are energized by the pace and momentum of the credit union's growth and they thrive on the sense of accomplishment. Although efforts are made to be inclusive in decision-making, many decisions are driven from

the top down. However, it is expected that managers run their branches and departments "like it's their own business" and are given considerable autonomy to do so.

The CEO of post-merger G&F was the previous CEO of United. He admits to being obsessive about tracking results and benchmarking and this emphasis on performance measurement and monitoring has created some discomfort and anxiety among the G&F managers. Prior to the merger, under a different CEO, G&F was very lax about performance measurement and management. Budgets are now branch based and branch managers are responsible for managing their individual branch's performance. G&F tracked performance only at the corporate level and, therefore, there was not the same level of individual accountability for results. For United, tracking and reporting on results is second nature to the way managers' operate, but for G&F managers, this level of attention on their individual results has caused some defensiveness and concern that "someone's checking up on me." In addition, because G&F has never had any "tough times," it tended not to concern itself with aggressively managing potential problems. In contrast, United is proactive in monitoring trends and jumps on concerns before they become a problem.

The measuring and monitoring of performance supports a cost-based strategy; however, coupled with increased autonomy and accountability, it clearly supports a differentiation strategy. By giving managers the information and tools that they need to make quick decisions, they can make more informed decisions faster, enabling them to be more responsive to members and to differentiate G&F from slower, less nimble competitors.

Culture clash is often blamed if mergers fail or do not achieve the intended synergies. It is believed there exist strong similarities in culture between G&F and United, and that differences that exist are simply differences in process. One common definition of corporate culture is simply "the way we do things around here." While G&F and United may have similar philosophies surrounding the cooperative movement and member service, culture goes much deeper than that. The processes that have developed in each organization are reflective of the culture of each firm. Degree of autonomy and control, the degree to which teams are used and how they work together, openness and responsiveness to change, how problems are solved, attitude towards risk, etc. are some examples of ways in which these cultures differ, and are reflected in the processes, policies and procedures of G&F and United. Simply changing and adopting new policies as best practices ignores the cultural impact of making these changes. The integration process will highlight the degree to which these differences create conflict.

3.3.1 Insights on Strategic Fit

The review of the strategic fit variables suggests that current practices of each of these credit unions have them floating in the middle of a cost-based strategy and differentiation strategy. With the merger, however, it appears that there is the potential for G&F to move closer to a differentiation strategy, but given the resources of the credit union, it is probable that the shift will be slow, particularly since the shifts required also require shifts in culture. Although the variables lean toward a cost-based strategy, in reality, the focus on costs is largely to enable them to "stay in the game" versus achieve a competitive positioning based on costs. G&F may now be of sufficient size to afford independent investment in R&D, marketing, and product and service development in order to differentiate itself from banks and other credit unions.

As this merger places G&F among the ten largest credit unions in the province, it will begin to achieve sufficient scale to begin to consider options that it was unable to consider before because of costs. Relative to the banks and potential new entrants into the financial services industry, this credit union will have extreme difficulty in establishing a cost-based strategy. Hence, the focus for G&F should be to establish a means to differentiate itself from its competition, particularly other credit unions. As products and service offerings are largely non-differentiable and easily imitated, the greatest opportunity for differentiation is through the implementation of a service strategy that differentiates G&F from its competitors. However, for those products and services that are clearly superior to that of competitors, the credit union needs to increase awareness of the benefits of its offerings.

Related to the service gap is the gap in human resources. Although G&F has recently hired a Manager, Human Resources, the resources of this area are insufficient to deal with day-to-day human resources activities as well as develop and implement a human resources strategy to support business goals. Without a skilled, motivated and talented pool of people working in the organization, it will be extremely difficult to build a high performing organization and to differentiate on service. Hence, G&F needs a senior human resources person to not only deal with change management and transition issues for the merged entity, but to also develop and implement a human resources strategy. Increasing the overall skill level in specialist and management positions is also critical as the current depth of skills and expertise may be lacking in critical areas.

Despite the indication that there is a weak strategic fit with the current activities and generic strategy, it is likely that the credit union's size may continue to drive many of its activities and hinder its ability to position itself on either end of the strategy – cost-based or

differentiation. Although the increased size and related organizational changes should help to move G&F closer to a differentiation strategy on some variables, it will continue to be challenged with a "stuck in the middle" approach.

3.4 The Value Chain and Core Competencies

The following discusses the primary and the more significant support activities that make up the value chain for the merged entity. However, because decisions have not been made with respect to the new process for some activities, the processes of each credit union are discussed and differences noted.

Figure 10: G&F Value Chain

Source: EMBA 607 Strategy Seminar, Ed Bukszar, 2004 (Adapted with permission)

FIRM INFRASTUCTURE	Planning (tactical & strategic) Merger integration	Policies and procedures development IS implementation and maintenance	Facilities maintenance and management Risk management & security	Accounting (including budgeting, payroll, clearing, collections) Administrative support	Financial management (investment and treasury activities)
HUMAN RESOURCES	Recruiting Training & development	Benefits administration Performance management	Compensation administration	Collective bargaining Labour/employee relations	HR information management
TECHNOLOGY DEVELOPMENT		Banking systems customization and integration (mergers)		Data mining Market research Member research Research & development	
PROCUREMENT		Facilities/Real estate acquisition or lease Banking systems acquisitions/service contracts	Statement processing services Financial tools	Advertising space Printing services Distribution services Marketing materials Marketing consulting services Product acquisition (mutual funds, insurance)	
PRIMARY ACTIVITIES	Deposit gathering Branch treasury mgt Asset/liability management (i.e. cash inventory management)	Branch operations Operation of alternative delivery systems (ATM, phone banking, and internet banking operations) Member services (advisory services and order-taking) Commercial lending Retail lending Delinquency management	Statement production Transaction processing & order fulfillment (3rd party products) Transaction processing (banking services) & order fulfillment (e.g. disbursement of funds) Payment processing & clearing Completion and submission of documentation for product sales and trades	Advertising Promotions/campaigns Pricing Customer education Community relations Member relations Press releases Product development Workshops & seminars	Post sales follow up activities Problem resolution
	INBOUND LOGISTICS	**OPERATIONS**	**OUTBOUND LOGISTICS**	**MARKETING & SALES**	**SERVICE**

Core Competency – activities performed in-house

Activities performed in-house and externally (e.g. member research)

Activities fully performed in-house

Activities fully outsourced.

3.4.1 Primary Activities

3.4.1.1 Inbound Logistics

The activities performed by both United and G&F relating to inbound logistics activities focus primarily on deposit processing activities that generated the funds lent to customers, "inventory management" of these funds, receipt of currency for in-branch treasury supply, and safekeeping activities. Deposits that "enter" the credit union are primarily electronic accounting entries, rather than receipts of physical funds. Advice of funds transferred into the credit union is part of the reporting provided by CUCBC's clearing function (discussed in detail under outbound logistics). Each branch monitors its foreign and domestic currency levels and initiates currency orders based on its assessed needs.

Liquidity management is an important activity in banking and akin to inventory management in this industry. Liquidity management drives the "ordering of funds" and asset/liability management is used to match term and rate structures of deposits and loans. For example, effective management of funds on deposit enables the credit union to avoid supply shortages relative to loan demand that would necessitate paying a premium price to gather deposits. Alternatively, the credit union does not want to be in a situation of excess inventory of deposits (i.e. excessive liquidity) on which it is paying interest and is unable to "sell" in the form of a loan.

Liquidity management and basic asset/liability management activities are conducted in-house. To supplement in-house asset/liability management activities, an external specialist is used to conduct more thorough forecasting and analysis. The consultant conducts the analysis using special modelling tools. The asset/liability analysis indicates the credit union's degree of mismatch with its deposits and loans (both the term structures and interest rates) so that the credit union can manage its interest rate risk. Based on the assessment, the credit union may initiate remedial action such as advising staff to promote a particular term structure of a deposit or loan by offering greater discounts (loans) or premiums (deposits).

3.4.1.2 Operations

Branch operations play a significant role in the efficiency and effectiveness in serving members. Seamless delivery of services and minimization of inconvenience affect the cost experienced by the member and the resultant value to them. This can be affected by physical operations (e.g. separate physical locations used to offer different services) or by procedural operations (e.g. approval processes). In credit unions, branch operations are akin to the factory

floor in manufacturing. It is the core of the business. Hence, primary activities are quite comprehensive and categorized as member service, branch operations, and operation of alternative delivery systems. The support functions that facilitate operations are also extensive and comprise some of G&F's core competencies.

3.4.1.2.1 Member Services

Serving the member includes advisory services related to banking and investment products and services, sale of products and services, and order-taking activities.[56] Member service is an area in which G&F endeavours to excel. In terms of competency, United considered member services as one of its core strengths and, while G&F considered itself as providing good service, it did not consider member service as one of its core strengths. However, United acknowledges that this competency is not at a level that it would consider as providing a competitive advantage. Among the United branches, the number of members per branch is low relative to that of its competitors.[57] This enables staff to develop a level of "intimacy" with members that is more difficult to achieve in a large, high volume branch. Although part of this intimacy is accomplished because of the "cozy" culture, staff are encouraged to be friendly, show an interest in the member as a person, and build relationships. The credit union believes that this level of intimacy between service staff and members is what sets G&F and United apart from many of their competitors.

3.4.1.2.1.1 Deposit/Investment Services

Processing of members differs based on size of the branch. In smaller branches, members go directly to the appropriate area of the branch based on their service needs; in larger branches, a "Greeter" is present who directs members to the appropriate service area based on the member's needs. This not only ensures that members are not wasting time in the wrong area, and perhaps getting the wrong advice, but also enables more efficient processing of all members. If it is a basic transaction (deposit, withdrawal, or bill payment) the member queues for a teller who will then greet the member and take the order. If the member and teller know each other, friendly personal exchanges are encouraged that develop a sense of customer intimacy. During this exchange, the teller may identify other needs of the member. The teller then recommends credit union products and services that would benefit the member and pursues the opportunity to make a sale or a referral to another service expert.

The process is similar for the "member services" area of the branch. This area serves those people who have more specialized transaction needs (account openings and closures,

access to safe deposit boxes, RRSP and mutual fund purchases, card services, and estate handling). In addition to processing the order requested by the member, the service representative will also advise on, and promote, other products and services. A licensed representative handles all mutual fund transactions.

Members seeking investment advice, and who have a larger investment relationships (e.g. $25,000 or more), are referred to Financial Planners in the wealth management division. As only three branches have an in-house Financial Planner, an appointment is booked with a Financial Planner who will meet members at a location of their convenience. In the initial meetings, the Financial Planner develops an understanding of members in terms of their current financial position, financial goals, risk tolerance and level of investment sophistication. This detail is not gathered at every meeting with members, but the Planner is required to update this information on a regular basis. Many of the meetings, however, focus on conducting a transaction, perhaps involving some level of advice on recommended investments. The Planner completes the paperwork to initiate the transaction.

3.4.1.2.1.2 Personal Lending Services

Typically, an appointment is required to meet with a Lender, but members are also served on a walk-in basis if a Lender is available. The member and Lender meet to discuss the member's needs and the Lender recommends alternative lending products and structures to meet the member's (or potential member's) needs. The Lender completes the credit application and enters it into the loans origination system. The system generates the credit bureau rating and calculates a variety of indicators regarding the member's ability to service the loan. The current system in use does not generate automatic decision-making, but it will have this capability very soon; however, it will not be set up to decline a loan. The credit union believes that before a loan is declined, it should be reviewed by a person, and not just automatically rejected by a computer program.

If the loan is within the Lender's assigned lending limits and the member's credit score is acceptable, the Lender can approve the loan immediately. If the application is outside the Lender's limits, the application will be elevated to the branch manager for approval. If an application is outside the branch manager's authority, or the application does not meet the approval criteria, the application is e-mailed to the VP, Retail Credit for approval. All loan applications received by the VP, Retail Credit by 2:00 p.m. have a same business day turnaround. The credit union wants its Lenders to be aggressive in bringing in loans, therefore, only the VP

Credit has the authority to decline a loan. A process is in place that enables the Lender to appeal a loan rejection.

Although the time spent by the VP processing applications could be reduced if the lending limits in the branches were increased, the limits have been set such that approximately 10% to 15% of all loans cross the VP's desk. This is part of the credit union's risk management and control process to ensure that the Lenders are not "losing their edge."

Often loan rates are negotiated and, based on the member's actual (or potential) relationship with the credit union, the Lender may be able to offer a discount, particularly if there is a desire to attract a specified term to address ALM mismatches. The Lender also promotes other products and services, particularly if the member does not use the credit union as its primary financial institution. The Lender will use this opportunity to get more of the member's business and to sell complementary products (e.g. mortgage life and disability insurance).

The Lender advises on the next steps in the transaction process, completes all necessary paperwork for processing by the centralized credit office. The centralized office ensures that the required registrations have occurred, that the file documentation is complete and disbursements of the loan are made as per the instructions. Although G&F operated a centralized lending office, United performed loans administrative functions in the branch. The adoption of the centralized lending office will allow branches to focus on member services and increase loan processing efficiency.

Currently, all loans, including lines of credit, require two visits from the member – one to complete the application and another to sign off on the loan. Enhancements to the loans origination system will automate the due diligence process and, therefore, all automatically approved loans, except mortgages, will require only one visit from the member.

A critical part of the lending process is managing delinquencies and administering the collection process. G&F and United had different tolerance levels for managing delinquencies, with United more aggressively managing its delinquencies. Going forward, G&F will commence collection activities after a loan is seven days delinquent. For the first thirty days of delinquency, the branches administer the process, as they have the relationship with the members. After thirty days, the branch refers the delinquent loan to the Collections Officer at the administration office, who then takes over the collection process. During the collection process, every effort is made to find a way to help the member service the loan, including offering financial management/budgeting advice. Formal collection proceedings are a last resort.

Delinquencies are tracked weekly and monitored to ensure that delinquencies are being managed and not getting out of control. This rigourous process evolved in response to a problem that United had several years ago with loan delinquencies.

3.4.1.2.1.3 Commercial Lending

G&F has a commercial lending office in Richmond that supports all commercial lending activities for the credit union. Over the years, G&F has developed considerable strength in its commercial lending activities and considers this as its core competency. The capital adequacy requirements specify that if a credit union's commercial loans exceed 30% of its risk-weighted assets, its capital requirement is doubled, taking the required capital level from 8% to 16% for commercial loans over the 30% threshold. Because of the steep capital requirements and level of management expertise required to manage the greater risk involved with commercial lending, few credit unions aggressively develop their commercial lending business and few receive regulatory approval to do so. In recognition of its management capabilities, the regulators permit G&F to have up to 35% of its assets in commercial loans if it has sufficient capital.

The operational activities related to G&F's commercial loan processing are not significantly different from that of other financial institutions. Commercial loans are processed and approved according the Investment and Lending Policy that is approved by the regulators. However, the key value driver is the calibre of commercial account staff and the relationships they have built serving this market.

G&F began to cultivate the commercial lending market in 1982/83 with construction financing. At that time, the real estate bubble had burst and banks were not interested in financing construction loans. G&F saw an opportunity to serve this market and began to develop it. The previous CEO of G&F initially developed this niche and the builder relationships; he then developed the expertise of several other staff. Over the years, G&F has built a loyal customer base with builders and has grown its commercial loan business through word of mouth advertising. Funding of construction loans spans projects in the lower mainland and Vancouver Island. The volume of commercial loan activities at times is such that it would push G&F over its Investment and Lending Policy. In such cases, G&F syndicates the loans.

The VP, Commercial Lending attributes much of G&F's success in commercial lending to doing it different from the banks rather than doing it better. G&F has faster approval turnarounds than a bank; G&F's loans are approved locally whereas bank commercial loans are typically approved in a head office in Toronto. Markets and economies vary across the country,

so it is difficult for a Lender in Toronto to be knowledgeable about markets in B.C. As a result, a construction loan may be declined because Toronto is experiencing a slowdown in the housing market while in B.C. there may be a boom. Banks may take a week for an approval whereas G&F will take only two or three days. Similarly, G&F can issue a letter of credit within a day and a bank will take several days.

G&F believes it does a better job of meeting the member's needs. For example, in construction, cash flow is critical, as is flexibility. By having built its understanding of this industry, the credit union is able to structure the funding to meet the needs of its members.

Although construction loans are the largest component of its commercial lending business, G&F also specializes in fish boat loans, small business loans and commercial real estate loans (e.g. purchase of rental properties). In addition to hiring Lenders with solid commercial lending background, G&F provides considerable staff training on how to evaluate commercial loans and how to serve members effectively. G&F works to build industry expertise among its Lenders. Industry knowledge is critical for not only evaluating the financial statements, but to also understand the business success rates and competitive environment for an industry. This knowledge enables the Lender to evaluate the level of risk associated with a loan. The Lenders also stay informed regarding industry trends and the economy of the province. Depending on the economic trends and forecasts, the credit union will adjust the mix of industries in its commercial portfolio. For example, if the real estate bubble is about to burst, the credit union will scale back its construction financing and will look to increase financing of rental apartment purchases.

3.4.1.2.1.4 Support Activities

The human resources function comprises many important support activities related to member services, but most importantly, training. As the organization has evolved and grown, there has been an increasing acknowledgement that highly trained employees are integral to providing a high level of service to the members. The type of training provided is based on an assessment of the skills needed to achieve business objectives, to ensure regulatory compliance, and for individual employee development. Although there is increased awareness of the importance of developing employees' sales skills, there is considerable emphasis on matching member needs to products and services, versus pushing products and services that are of limited value to the member. Therefore, sales training focuses on training staff to identify needs and to "ask for the business."

Various sources and resources are used to train staff. Internal staff provide some training (e.g. basic product training and training on new regulations), and external resources are used to provide specialized program training (e.g. Canadian Securities Course, estate handling, effective people management, and sales training). Internal training may be informal on the job training or delivered through formal classroom sessions. Most in-house development of training programs is via customization of training programs acquired from other organizations.

3.4.1.2.2 Branch Operations

In addition to the provision of member services discussed above, other primary activities related to branch operations are planning of staffing levels and logistics planning (e.g. which customers go where for what services, and managing volume).

Cross-training of member service and teller staff ensures they are able to provide back-up services when line-ups begin to build and to cover for absences. To keep operations lean, additional staff are only hired when supported by transaction volumes. Due to a positive work environment, a generous compensation and benefits package, and limited use of part-time employees, United and G&F have low staff turnover. As a result, they benefit from having very experienced employees that are generally efficient and effective in their jobs.

To facilitate effective branch operations, there are a number of important support activities including facilities acquisition, maintenance, and management. These activities ensure that the branches are easily accessible to members, located in a desirable location, designed to support branch service structures, and clean and well maintained.

3.4.1.2.3 Branching

To grow its membership and to provide greater reach to existing members, G&F looks for opportunities to open new branches. To select an area for expansion, the Senior VP, Operations identifies communities with growth potential (new housing developments bring families and mortgages), and where the credit union has existing membership. The credit union selects new locations that are in areas adjacent to existing branches or along the same corridor. This approach makes it easier to develop the market as people will have some familiarity with the brand. Sites are selected in an area based on it meeting certain criteria – high visibility, ease of access, high traffic volume (e.g. in a mall with a major grocery store). Prior to the merger, neither credit union had undertaken branching activities for years – for both credit unions, branch expansion has come from mergers.

3.4.1.2.4 Merger Activities

To increase accessibility to branches throughout the GVRD, mergers with other credit unions have increased the number of branches from which members can access services. Support activities related to strategic and tactical planning and "acquisition" of other credit unions enables G&F to continue to increase the accessibility of services to its members. To support the merger activities, the credit union (mostly the CEO) has developed comprehensive profiles on credit unions including the age of other CEOs, banking system supplier, branch locations, union affiliation, and financial performance. Financial information on prospective partners is updated and monitored monthly. With this information, the CEO runs various scenarios through a modelling application to assess the impact and timing of various mergers. The CEO uses this information to assess the attractiveness of potential merger candidates in terms of ability to achieve efficiencies (common banking system) and complementarities (e.g. branch locations fill holes rather than overlap), and degree of culture fit. The CEO actively "works" his relationships with other CEOs to get first mover advantages. There are three criteria used in assessing a merger – is it good for the members, is it good for employees, and does it improve the corporate bottom line.

In addition to assessing the attractiveness of other organizations, the CEO focuses on ensuring that his credit union is fit and attractive to prospective suitors. A key area of focus is managing the salary and benefit costs by operating a lean organization. This enabled G&F to absorb all employees of both institutions and guarantee that there will be no job loss because of the merger. Employees have a significant influence on members' voting, as members will often ask staff their opinion of the merger; employees who fear job loss will not be supportive of a merger. If employees do not want a merger, then it is likely that the merger vote will fail. To promote the merger to staff both prior to and after the vote, the CEO and executive were diligent in doing town hall meetings with staff of both organizations to promote the benefits of the merger, and address issues and concerns.

While many organizations are successful in finding the "right" merger partner (or at least in rationalizing it), few organizations are good at implementation activities. Each time G&F's CEO leads a merger, the credit union improves and enhances its process based on learning from previous mergers. After each merger, process documentation is updated. A meticulous approach has been developed with "to dos" and timelines for all areas of the organization – systems, operations, human resources, marketing, etc. Significant activities include integration of accounting and banking systems; product alignment; alignment of employee pay and benefit

programs and collective agreements; alignment of policies and procedures; negotiation of contracts with suppliers of products and services; training of staff on products, services, policies and systems; and communication to members and employees. The less disruptive the change is for employees and members, the more positive they will be about future mergers.

G&F's strength in merger implementation (coming from the United side) has been attributed to the art that comes from experience and learning. There are between ten and fifteen people that comprise the core merger team. These individuals have been involved in three mergers in four years. They know the process and the potential pitfalls. They also know the magnitude of work involved with a merger implementation and, as a result, have developed a sense of urgency.

While people learn through experience and practice, working with a good process and model is integral to success. The merger process that is followed was adapted from a model built by a consulting firm for another credit union. The CEO first used this "A to Z" of implementation in the merger between Dairy and Pioneer in 1994, and it has been revised and re-used in all subsequent mergers.

Once the Boards of both credit unions agree to consider merging, the pre-planning stage commences. The objective of the pre-planning stage is to set the process and get the other side, on side. Committees are established with representatives from each credit union and each committee has terms of reference. Committees must meet weekly and provide minutes regarding their progress to the project manager. The project manager vets the minutes relative to the committee's terms of reference and established time lines. Committees are accountable for meeting their deadlines. If a committee runs into a problem, the expectation is that the committee bring it forward immediately. If it is having difficulty in attaining the cooperation of other individuals or teams, the committee is to address the problem directly, but if it cannot resolve the problem on its own, the issue is elevated for intervention and resolution.

The merger integration process begins with a due diligence process. In the due diligence process, each committee has its checklist which it follows to identify and document, in detail, the similarities and differences between the credit unions, and the implications for implementation. The due diligence documentation is filed in binders which become the bibles for implementation. After the due diligence process is completed, a planning session occurs where timelines and activities are determined and aligned. It is intended that the documentation completed in the due diligence stage indicates everything that needs to be done to complete implementation.

Although one credit union may have a strong and experienced merger team, the success of the implementation is contingent on both teams carrying out their activities effectively and on time. This can be a problem if only one credit union feels a sense of urgency and the other has a more relaxed approach. G&F's core merger team is sufficiently confident in its competence that if the other credit union is slow to respond to issues or questions, it will make a decision and keep moving, recognizing that it may need to go back and "mend fences." Everything that everyone does throughout the merger process is documented, and every little blip in the process is noted for improvement the next time around.

One of the primary measures of implementation success used by the CEO is how quickly systems are integrated and the credit union is able to provide seamless service to members. In the most recent merger, G&F is proud that its members could do inter-branch banking at any one of the twelve branches on the first day of the merger. Other credit unions have taken up to two years to be able to do this. One month and nineteen days after the merger, G&F had its banking system fully converted, yet other credit unions may not complete this task until well over a year after the effective merger date.

Due to the high costs of technology and administrative operations, firm size is critical to achieve scale efficiencies and enhance competitiveness. Because G&F is able to complete the merger activities quickly and smoothly, it is able to reap the benefits of scale efficiencies and with lower risk than with an internal growth strategy. G&F's ability to manage a smooth transition also makes it an attractive merger partner.

Prior to the merger with G&F, United complemented its competency in merger implementation with its efficiency and effectiveness in operating very lean. With the recent merger, it is questionable whether it will be able to achieve its pre-merger level of efficiency. Both credit unions assured their employees that no one would lose their job due to the merger. In the past, this commitment has not been problematic as one of the credit unions was sufficiently small that the larger entity could easily absorb the new staff. Typically, the only management staff were branch management and the General Manager. Branch managers were needed to operate their branches and the General Manager usually retired.

Under the merged entity, executive positions have been created that do not appear to be supported based on business needs, but driven by an obligation to fit people within the new organization at their current level. For example, a credit union of this size typically has an executive level human resources position and, if it has an executive level credit position, there is

only one, not two, VPs of Credit. The CEO acknowledges that the organizational structure at the top of the firm would look quite different if he had the ability to start with a clean slate.

In addition, there has been no elimination of redundancies of administrative staff. Typically, when two adequately staffed firms merge, there are redundancies of administrative and management staff. To exploit opportunities to achieve scale efficiencies, positions are eliminated. By not eliminating positions, G&F may not able to take full advantage of potential administrative efficiencies. Although it may be able to grow to fit its staff size, G&F cannot continue to merge and commit to "no job losses." It is irrelevant that the credit union's salary and benefit costs are below the industry average if the credit union does not have the right people in the right jobs, nor have the resources to retrain employees to fill gaps in the organization. This is simply an ineffective allocation of resources, and hinders the credit union from developing the skills it needs to differentiate itself from its competitors.

3.4.1.2.5 Alternative Delivery Systems (ATM, WWW and Phone)

Alternative delivery system operations are those activities that ensure for accessibility, security, and reliability of services via these channels. Specific activities related to on-site servicing of ATMs (replenishment of cash and supplies, and pick-up of payments and deposits) are also necessary to ensure for the reliability of service provided. These activities are performed either in-house or outsourced. As with branch operations, ATMs are serviced with peak periods in mind. For example, ATMs are supplied with additional cash for long weekends when there is a longer gap between service periods and members tend to use more cash.

Online banking activities not only enable members to process transactions electronically, gather information on products and rates, and use various "calculators," they are also able to apply for credit union memberships and inquire about loans and mortgages on-line. Loan inquiries are received in an electronic mailbox and forwarded to members' branches. A Lender contacts the member to start the application process. The approval process is the same as an in-branch application and the member will be required to sign off on the paperwork. Membership applications are forwarded to the appropriate branch and a credit union service representative follows up with prospective members to process their membership applications.

With phone banking system operations, the primary activities related to these systems is that of setting up new users, user support, monitoring system performance, and system recovery.

Activities that support the delivery of services via technology include information systems support (upgrading of services and systems, trouble-shooting, and acquisition of

hardware and software needed to deliver services). This involves regular servicing and maintenance of these systems.

3.4.1.3 Outbound Logistics

Outbound logistics includes those activities that complete the member's transaction. This includes activities relating to order fulfillment such as transaction processing (e.g. disbursement of funds), processing of documentation to complete a trade or register a sale (e.g. insurance product or mutual fund), and statement production. Many of the outbound logistics activities are closely linked to operations activities; outbound logistics for many products and services is simply the electronic entry that finalizes the transaction. For example, when a teller posts a member's withdrawal on the credit union's banking system, collects the cash from the cash dispensing machine, and then disburses it to the member, the order is fulfilled, and transaction completed.

When a member deposits a cheque, the outbound logistics involves not only the posting of the transaction on the banking system, but also the electronic transfer of funds that occurs through the clearing system at Credit Union Central of B.C. Although the transaction is posted in the banking system, the funds are "held" until the cheque has cleared. Part way through the day, a courier picks up all of the payments (e.g. utility bills) and deposited cheques at each branch, and delivers them to CUCBC's clearing centre for processing that evening. It is through the clearing system that funds between accounts are transferred throughout the national payment and clearing system. The next day, reports from CUCBC are sent to the credit union advising of rejected items such as NSF cheques, and the amount of funds that are debited or credited to the credit union's clearing account.

The support activities conducted by the accounting department are integral to completion of the outbound logistics. The accounting department of the credit union receives and processes the clearing reports from CUCBC, posts the summary amounts to the credit union's general ledger, posts adjusting entries, and advises the branches of members' rejected items. The branch follows up with the member to arrange for settlement. At the end of the month, an outsourced service provider produces and mails member statements.

Outbound logistics for third party products (e.g. mutual funds and insurance products) differ from that of banking transactions. G&F does not have its own mutual funds back office so it uses the services of its dealer, Credential Asset Management (CAM) for in-branch transactions. The branch Compliance Officer processes the paperwork for trades. The Compliance Officer

reviews the paperwork for compliance and faxes the trades (within 24 hours) to CAM for processing. CAM produces and distributes all statements and receipts related to a member's investment account and trade activities. For transactions originating from the subsidiary, the process is essentially the same except that Dundee Wealth Management (formerly Cartier Partners) provides back office functions for the subsidiary.

Although there are some advantages to having a relationship with two dealers, it does bring some challenges. Two dealers gives the credit union greater power in bargaining with each supplier. In addition, each of the suppliers offer services and support that are better suited to the respective investment delivery channels (in-branch and the subsidiary) of the credit union. The two dealers provide different products (e.g. one offers the credit union system's Ethical Funds and the other does not). However, problems occasionally arise when members who have been receiving in-branch investment advice go to the subsidiary for investment advice. The Financial Planners in the subsidiary have been known to criticise the member's investment portfolio, which then negatively affects the credibility of the in-branch investment services. Although there could be other issues at play, the lack of common supplier does not promote a perception of seamless delivery to the member nor enhance the credibility of the credit union's investment advice.

Outbound logistics for insurance sales differs in that the credit union representative completes and submits the paperwork to the insurance company online or via paper, and the insurance company forwards the policy to the member.

3.4.1.4 Marketing

In the short-term, marketing activities for G&F will continue to focus on member communications related to the merger. Although it is anticipated that the merged entity will achieve greater efficiencies with the combined marketing resources, there is no specific strategy in place as to how the combined resources will be leveraged to enhance G&F's marketing initiatives. Generally, though, there will be more emphasis on advancing the credit union's sales and service activities and building brand awareness. With the combined marketing budgets, and broader geographic spread, G&F plans to do more advertising in the provincial daily papers and perhaps consider radio ads when it opens its new branches.

Prior to the merger, marketing priorities for each of these credit unions differed significantly. Since its adoption of the G&F Financial Group trade name, G&F's marketing has focused on building awareness of the G&F brand and its credibility in wealth management. This included considerable consulting fees with the development of the new name and fees related to

promoting its new name and wealth management business. Due to its merger activities in the last three years, United's marketing efforts have focused on member communications, and product and service alignment initiatives. Except in 2003, promotions and advertising expenses for United have lagged G&F in terms of total expenditures, and expenditures as a percent of total revenues. Over the last four years, United's promotions and advertising expenses varied from just over 1.0% of total revenue to over 2.5% of total revenue, and G&F's expenditures have been relatively stable at approximately 2% of total revenue with a peak of 3.25% percent in 2002 when it introduced its new name. The combined expenditures of both credit unions in 2003 were just over $500 thousand.

3.4.1.4.1 United Savings' Marketing Activities

United's primary activities related to marketing included advertising, promotions and campaigns, pricing, product development, community and member relations, and press releases. Because of the frequency of mergers, and resultant name changes, United's marketing has not involved any branding and the merger activities have required considerable focus on communications and promotions to support merger activities. Members receive newsletters with their statements and direct mail-outs that advise them of changes and the impact on them. In addition, the credit union provides members with "new member packages" that include new cheques, pens and other promotional materials.

To develop its business, United conducted various marketing activities. United focused on developing its existing relationships and achieving greater penetration in the communities in which it is located. As a result, marketing activities were targeted. Using existing databases and member profiling, United mailed out letters to specific members to promote certain products. For example, the credit union may notify members that they are pre-approved for a low interest loan for $10,000. United also used mail drops in its communities to promote the credit union and current campaigns.

Branches also undertake their own localized marketing. For example, a branch that has a large number of members from a particular workplace (typically a unionized workplace such as Dairyland or a fire hall) will visit the worksite with donuts to promote the credit union's services and to keep the credit union top of mind. Branches also actively support and participate in community events such as Hyack Festival (New Westminster), Fleetwood Days (Surrey), and sporting events (e.g. B.C. provincial swim meet in Surrey). The credit union also has a member referral program and runs contests to generate growth.

The annual marketing plan includes activities that do not vary from year to year – the RRSP campaign in January and February, the spring loans campaign, and the fall deposit campaign. All newspaper advertising is linked to these three campaigns. United typically placed its advertising in local community newspapers, but this year United ran a few ads in the Vancouver Sun and Province. To promote RRSP business, the credit union annually reviews and refines its portfolio of RRSP products such as term deposits and RRSP loans. Term deposit and RRSP loan pricing is based on the competitive marketplace .

The marketing department also monitors the competitive environment with respect to product and service offerings, promotions, and pricing. This information, along with publicly available economic research, member research (internally produced and acquired), and other internally available information is used to determine new product and service offerings, and pricing.

The fund dealer (e.g. CAM) and the insurance company provide promotional materials for third party products (e.g. mutual funds and insurance) to the credit union.

3.4.1.4.2 G&F's Marketing Activities

G&F's focus has been on developing its wealth management business. In the late 1990's, the thought in the retail banking industry was that wealth management was the business to pursue as retail banking was forecasted to have limited future profitability. G&F started its wealth management subsidiary approximately four years ago when it operated under the name of Gulf and Fraser Credit Union. With limited success in building this business, it undertook a review involving focus groups. Through the focus group process, it found that it had a credibility gap. The information from the focus groups indicated that fishermen are not perceived as knowledgeable about financial planning and investing, nor are credit unions. Hence, the credit union decided to rename itself and drop all references to it being a credit union. It felt that these actions would increase its ability to attract new business.

Since May of 2002 when the new name was unveiled, G&F's marketing has focused on building brand awareness and its wealth management business. Like United, many of its branches are in communities with limited growth in retail banking, so the focus has been on building share of wallet. The intent is that by offering wealth management services, the credit union can offset some of the drain in deposits that occurs when markets are performing well and interest rates are low. In addition, the credit union would prefer to have one member with five products versus five members each with one product. However, if its focus is to increase its

share of wallet of existing members, then the re-branding scheme to address its credibility among non-members contradicts this focus.

G&F also prepares and designs a variety of print media – brochures, flyers, advertising and newsletters – all of which are designed in-house and sent out for printing. Advertising is done in community newspapers throughout the year and it has not advertised in the provincial newspapers. It has also done some sponsorships with B.C. Business' publishing of the "97 Tips" booklets written by Peter Legge.

G&F spends less time in building brand awareness through community events. Instead, G&F tends to offer workshops and information sessions for its members regarding financial planning and investing. It sets up information booths in the lobby of the Hydro buildings where it has branches, and promotes its full range of financial services, especially wealth management services.

G&F does limited product development/redevelopment as it has high levels of renewal of existing products and it feels there is no need to change. Other marketing activities performed by G&F (e.g. data-mining and purchase of published consumer research) are similar to that performed by United.

3.4.1.4.3 Service

Service activities are a significant focus at the time of the member transaction; however, neither United nor G&F performed post-sales, service activities on a consistent basis. The most significant area of post-sales service in banking is problem resolution. Problem resolution activities focus on investigating and correcting the problem. Neither credit union had a formal process to "make up" for the inconvenience caused by an error. However, on an informal basis, G&F tended to compensate for an inconvenience depending on the magnitude of the problem and the value of the member. Branches also conduct "exit interviews" with all members who close their accounts. If the member is leaving due to an incident, the goal is to rectify the situation and retain the member. Exit interview information helps to identify whether an incident is an isolated one or not, and determine the action necessary to ensure that the problem does not occur again.

Although inconsistent, some branches do have "member rewards." For example, some branches will send a members a "house warming" gift when members finance the purchase of their new home through the credit union. With G&F, this tended to be a golf package whereas

United's gifts tended to be more domestic. G&F is currently considering a formal rewards/recognition program related to loans for vehicle and home purchases.

While other service activities focus on providing post-sales service, they also have a marketing objective. For example, the credit union provides customer education on tax and investment issues via newsletters included with members' statements, but the underlying objective is to stimulate members' awareness of unmet needs that the credit union can fulfill. Similarly, when the credit union follows up with members to remind them of upcoming renewals (e.g. term deposits and mortgages), the intent is to make contact with members to renew the contract before they renew with a competitor. Financial planning and investment seminars, while providing value to members, have the desired goal of increasing the credit union's wealth management business.

3.4.2 Support Activities

3.4.2.1 Firm Infrastructure

United has considerable strength is in this area. Specific areas of strength are financial management, planning (strategic, tactical and budget) and system integration. These activities not only play a significant role in supporting day-to-day business activities throughout the organization, but also in enabling the credit union to respond adeptly to change (e.g. mergers, computer system changes, and procedural changes). The fact that the CEO is relentless in measuring and monitoring performance, and obsessive about documentation of processes, is likely a key factor in driving the efficiency of the credit union, particularly the back-office support functions.

3.4.2.2 Human Resources

Human resources support is a functional area that was weak in both G&F and United. The number of staff supporting human resources was low, as well as the level of expertise. As a result, human resources activities focus on day-to-day operational needs – recruiting, training, employee relations, salary and benefits administration and, in G&F, managers tended to do deal with human resources issues in their own way. Neither G&F nor United perform activities related to strategic human resources planning and implementation. As a result, human resources activities focus on meeting today's needs versus planning for future needs, and building programs to support those needs.

In recognition of this weakness, G&F recently hired a Manager, Human Resources. The focus of this position is to address alignment of various human resources programs such as

benefits, compensation and performance management. Unfortunately, because of the limited resources allocated to human resources activities, neither organization had a solid human resources platform to support the organization. Given its current size, G&F is in dire need of human resources structure in order to manage its employees and operations consistently and effectively. Despite the addition of a new HR Manager, the function is understaffed, especially considering the work needed to build the human resources function and keep pace with rapid organizational change.

With no labour relations expertise in either organization, management has typically been soft in resolving grievances; hence, it is not surprising that both organizations report a tendency toward an "entitlement mentality." On the United side, when collective agreements expired, the Senior VP, Operations would represent the credit union at the bargaining table as the chief negotiator, despite having limited labour relations background and expertise. While G&F did hire the services of a negotiator to act as its spokesperson, the employer's committee was comprised of the Operations Manager as well as a Board member. In 2004, United's union contract will expire and not only will require renegotiation, but also an amalgamation with the G&F contract. G&F is considering whether it will hire a negotiator on contract to negotiate this collective agreement.

Interestingly, United's positive work environment and culture appears to have compensated in part for its weakness in human resources. Many employees are passionate and excited about the growth and mergers as they see it as an opportunity to enrich their jobs, develop their skills, and grow with the organization. Thus, although employees must work hard to achieve tough goals, the culture does promote having fun at work. In addition, the credit union recognizes and rewards employee efforts.

Employees from the G&F side, particularly managers, are more pensive regarding the changes arising from the merger. Rather than seeing it as a "merger of equals," some view the merger as a takeover by United. The degree of change required of G&F employees is more significant than that required of United employees as many of the processes adopted originate from United. Although processes and policies are adopted based on best practices, there seems to be a perception that United is taking control. As mentioned earlier, these changes in process are, in fact, a change in culture and need to be managed as such. Otherwise, this change process has the potential to negatively impact employee morale and member service. Therefore, G&F must monitor and manage the merger integration from a culture change perspective.

In the past, the small size and flat structure of these two credit unions enabled the executive to be close to staff and maintain open lines of communication with them. However, with the increased size and complexity of the organization, maintaining the current level of employee intimacy will be a challenge and require greater effort from the executive.

3.4.2.3 Technology Development

Banking systems customization and integration activities play an important role in supporting both merger activities and on-going business needs. This is an area of strength for United as it is able to quickly and seamlessly "cut over" banking systems. United has developed its skill in this area by having highly skilled staff and by repetition – practice makes perfect. G&F has not had the same need or opportunity to develop its skills in this area. Therefore, it is adequately competent in day-to-day systems maintenance, administration, and trouble-shooting.

Many of the less complex, technology development activities for marketing are performed in-house; however, more in-depth research is either purchased or contracted out. Many of the support activities performed in-house related to marketing address day-to-day marketing activities. G&F acquires more in-depth market research from CUCBC and it out-sources member research services.

3.4.2.4 Procurement

A myriad of procurement activities occur to support various aspects of the credit union; however, the more significant procurement activities are those relating to acquisition of technology products and services. These include ATM machines, web banking system and services, banking system, statement processing services, various specialized software tools (loans approval system and financial planning tools), consultants (e.g. asset liability management, HR and training and auditors), and facilities maintenance services. Some of these services are simply renewal contracts based on existing relationships.

Procurement activities involving greater expenditures will involve development and distribution of RFPs to prospective vendors. The basis for acceptance of a proposal is cost, capability of the vendor, and the vendor's reputation. Unlike the manufacturing industry, procurement activities in retail banking do not comprise a significant component of business activities.

3.4.3 Concluding Comments – Value Chain

Although G&F has achieved considerable strength in many of its support activities, particularly related to operational efficiencies, and merger strategy and implementation, it has

not developed this same level strength in its primary activities. While merger activities have enabled the credit union to expand its reach through more branches, the level and quality of services has not benefited proportionately from this increased scale. Perhaps with the increased staff in human resources and the creation of a sales and service function, the credit union will be able to dedicate more resources to improving the level and consistency of its services. With the plan to continue to grow, managing culture and change will be an ongoing challenge. An advantage with the increased size is that the credit union will be better able to host in-house training sessions without creating operational staffing conflicts in the branches.

The ability for staff to develop a level of intimacy with members does differentiate G&F from other larger financial institutions and, with the exception of commercial lending, services are not differentiable, particularly at the post-sales service level. However, member service is continually improving due to increased training and development activities.

While the type of activities provided in-house versus outsourced make sense based on related learning effects and competencies, the challenge with G&F's value chain is the fact that there is generally an under investment in several of the activities that support business development (e.g. marketing, human resources, and training and development). Due to limited financial resources, marketing activities have been cost-driven. However, while United's activities did not build brand equity nor differentiate it from other credit unions, G&F's marketing efforts have attempted to build brand awareness. In 2004, the marketing emphasis will continue to focus on the merger, and the expectation is that marketing activities in 2005 will emphasize the provision of a full range of financial and investment services, and branding activities.

In spite of both credit unions' weakness in human resources support, neither seem to have suffered in terms of poor employee relations nor negative work culture. However, if G&F does not manage the culture change process effectively, staff morale and service delivery could be impacted negatively. However, given the positive work environment in the past, an increased investment in human resources may enable it to enhance the potential of its people. As a service based organization, G&F should strengthen its competency in human resources, particularly since this is an area of organizational weakness. Assuming that well designed and administered human resources programs have a positive impact on employee performance and productivity, G&F is missing the opportunity to transform its human resources into a means of differentiating itself from its competitors.

Currently, the strengths in this organization are inward, versus outward focussed in that activities focus on reducing costs of production versus a focus on increasing the value of the credit union to the member. To implement a differentiation strategy, United should be putting more effort into outward, or member-focussed, activities such as marketing and human resources.

3.5 Financial Analysis

As the asset transfer related to the merger of United and G&F only took place May 1st 2004, consolidated financials were not available at the time of writing. Therefore, financial data is reported separately for each credit union. To facilitate comparison to groups of other credit unions, the financial data reported here is that submitted to the B.C. Financial Institutions Commission (FICOM) and Stabilization Central Credit Union.[58] This data will differ from that reported in the annual report due to differences in accounting methodology for regulatory purposes versus internal reporting purposes. Differences that may exist are generally immaterial.

For benchmarking the performance of United and G&F credit unions, data representing the average performance of two credit union comparator groups are included. The two comparator groups are Peer Group 5, which is comprised of the seven largest lower mainland credit unions, of which G&F is the smallest and United is not a part. The second comparator group is Asset Group 2 and includes all B.C. credit unions with assets between $200 million and $500 million. (See the Appendix for respective lists of credit unions in each of these two groups.)

Three sets of performance criteria are used to assess performance. The first area of measurement evaluates the soundness and stability of the credit union, the second area measures profitability and efficiency, and the third measures the credit union's growth. The four-year review of the financial results of G&F and United highlight the current financial strength of the two amalgamating credit unions. The four-year perspective of United's data illustrates the trend in its financial results and whether its merger strategy and leadership has had a positive, negative or neutral effect on its financial performance. The G&F review provides clarity regarding the effectiveness of G&F's operations and strategic direction. To the degree that each credit union has been pursuing different strategies, the financials provide some indication of the success of their respective strategies. Secondly, understanding the current financial health and the trend in financial performance is necessary to determine the ability of the merged entity to pursue various strategies, and to identify financial issues that may require immediate attention.

Table 5: United and G&F Income Statements (2000-2003)[59]

	G&F 2000	G&F 2001	G&F 2002	G&F 2003	United 2000	United 2001	United 2002	United 2003
FINANCIAL INCOME								
Liquid Investments	1,645,587	2,396,256	1,650,361	1,766,658	2,109,180	2,766,920	2,218,376	2,003,653
Other Investments	75,783	186,293	116,658	172,973	37,484	83,647	116,847	123,532
Loan Interest-Personal								
Real Estate Secured	9,515,672	9,061,656	7,673,814	6,878,980	5,983,420	8,070,451	8,437,393	9,413,549
Otherwise Secured	700,410	831,763	864,193	859,955	380,640	418,490	429,708	575,005
Unsecured	404,355	394,070	410,844	535,901	253,017	441,162	513,196	530,734
Lines of Credit	950,812	844,821	779,610	976,057	302,770	336,486	341,982	412,037
Loan Interest - Commercial								
Real Estate Secured	5,245,961	5,103,987	5,117,969	5,071,936	2,450,420	2,830,708	3,195,715	3,617,838
Otherwise Secured	498,200	339,016	306,204	275,341	56,447	54,676	49,745	55,832
Unsecured	9,168	9,859	5,208	4,711	3,271	2,001	1,971	4,802
Lines of Credit	421,652	420,267	281,346	297,888	170,994	117,947	112,013	132,103
TOTAL FINANCIAL INCOME	**19,467,600**	**19,587,988**	**17,206,207**	**16,840,400**	**11,747,643**	**15,122,488**	**15,416,946**	**16,869,085**
FINANCIAL EXPENSE								
Borrowings Interest								
CUCBC Operating Account	120,974	5,723	14,147	15,115	33,064	14,475	11,601	11,603
CUCBC Term	225,256	0	0	0	0	1,378	5,818	1,382
Demand Interest								
Chequing-Untiered (Basic)	139,175	209,343	127,744	96,176	569,248	545,847	326,523	392,015
Chequing-Tiered (Maximizer)	32,147	29,373	21,195	21,160	0	10,534	0	0
Daily Interest (Plan 24)	42,604	48,766	71,605	68,833	37,932	40,902	26,594	32,887
Minimum Balance (Special Savings)	0	0	0	0	0	1,980	0	0
Investment (T-Bill Savings)	407,880	245,605	144,011	145,182	211,125	205,788	101,774	81,560
Registered Plans	110,636	83,474	70,402	72,311	869,829	859,718	859,599	759,104
Other	0	0	0	0	2,118,145	1,829,059	1,732,558	1,491,153
Term Interest								
Regular/Premium	7,292,975	7,764,793	5,755,533	5,042,744	2,345,771	3,115,105	2,210,520	2,582,327
Registered Plans	3,322,411	3,534,982	3,182,946	2,762,965	1,227,194	2,020,668	1,809,747	1,961,615
Non-Equity Share Dividends	15,831	11,539	0	4,237	0	8,412	21,008	9,744
TOTAL FINANCIAL EXPENSE	**11,709,889**	**11,933,598**	**9,387,583**	**8,228,723**	**7,412,308**	**8,653,866**	**7,105,742**	**7,323,390**
FINANCIAL MARGIN	**7,757,711**	**7,654,390**	**7,818,624**	**8,611,677**	**4,335,335**	**6,468,622**	**8,311,204**	**9,545,695**

Table 6: Income Statement (2000-2003) (Continued)

	G&F 2000	G&F 2001	G&F 2002	G&F 2003	United 2000	United 2001	United 2002	United 2003
NON-FINANCIAL INCOME								
Member Services	1,795,063	2,050,015	2,209,193	2,518,679	1,215,595	1,831,121	2,043,984	2,846,263
Equity Investments (10% or Greater)								
Subsidiary and Other Equity Investment Earnings - Net	-827	-58,780	-116,942	-96,906	0	0	0	0
Other	68,043	63,107	75,427	89,638	11,705	127,584	70,088	46,196
TOTAL NON-FINANCIAL INCOME	**1,862,279**	**2,054,342**	**2,167,678**	**2,511,411**	**1,227,300**	**1,958,705**	**2,114,072**	**2,892,459**
NON-FINANCIAL EXPENSES								
Salaries and Benefits	3,832,640	3,915,714	4,445,413	4,633,884	2,432,851	3,238,923	4,045,247	4,553,152
Data Processing	623,049	651,516	632,328	611,902	462,967	679,644	793,936	806,535
Premises and Equipment	708,673	768,884	749,433	804,193	434,001	545,502	605,964	619,999
Depreciation/Amortization	412,597	362,793	435,259	467,350	285,783	399,966	438,424	667,987
Loan Losses-Net	581,735	240,000	200,000	400,000	211,562	502,747	460,766	453,499
Other	1,710,540	2,068,883	2,285,928	2,263,276	1,105,162	1,534,985	2,042,041	2,301,173
TOTAL NON-FINANCIAL EXPENSE	**7,869,234**	**8,007,790**	**8,748,361**	**9,180,605**	**4,932,326**	**6,901,767**	**8,386,378**	**9,402,345**
NET OPERATING INCOME (LOSS)	**1,750,756**	**1,700,942**	**1,237,941**	**1,942,483**	**630,309**	**1,525,560**	**2,038,898**	**3,035,809**
Equity Share Dividends	138,809	121,325	132,739	130,265	67,635	70,814	71,538	99,384
Patronage Refunds	0	0	0	493,444	216,812	240,524	198,777	160,179
Income Taxes	556,665	213,581	497,476	553,819	90,000	211,987	355,402	555,250
Capital Gain (Loss) / Extraordinaty Items	0	0	0	0	68,808	0	8,425	0
TOTAL DIVIDENDS & TAXES	**695,474**	**334,906**	**630,215**	**1,177,528**	**305,639**	**523,325**	**617,292**	**814,813**
NET INCOME (LOSS)	**1,055,282**	**1,366,036**	**607,726**	**764,955**	**324,670**	**1,002,235**	**1,421,606**	**2,220,996**

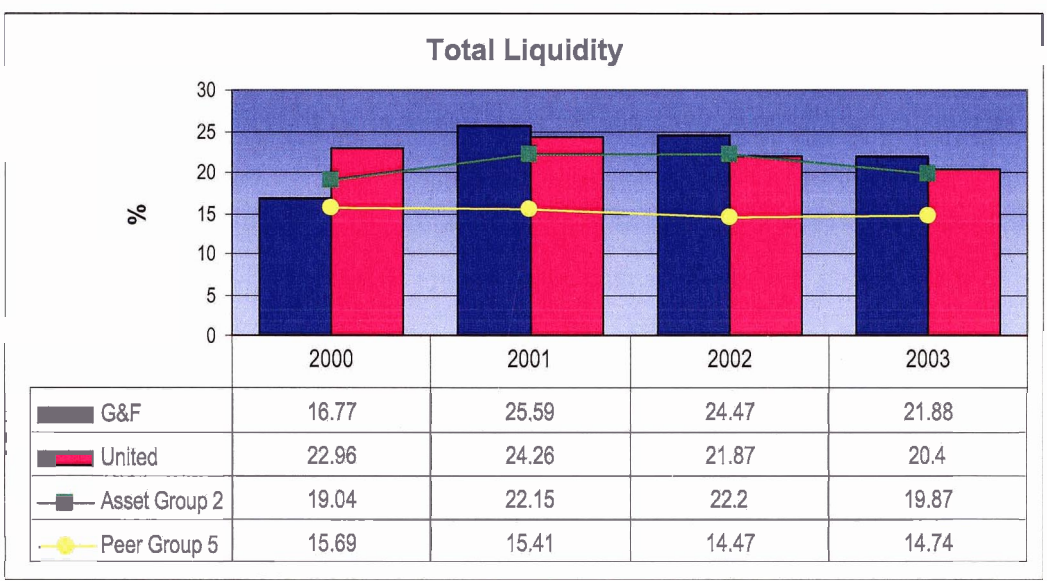
Table 6: United and G&F Balance Sheets (2000-2003)[60]

	G&F 2000	G&F 2001	G&F 2002	G&F 2003	United 2000	United 2001	United 2002	United 2003
ASSETS								
CASH & INVESTMENTS								
Cash & Liquid Investments	44,761,386	75,293,467	72,451,272	63,798,312	38,640,192	55,451,713	63,192,707	62,890,257
Other Investments	1,301,406	1,328,889	1,290,756	1,267,628	789,717	989,148	1,167,923	1,159,051
TOTAL CASH & INVESTMENTS	46,062,792	76,622,356	73,742,028	65,065,940	39,429,909	56,440,861	64,360,630	64,049,308
LOANS								
Personal Loans								
Real Estate Secured	142,269,135	134,612,011	129,032,650	132,059,541	93,342,193	124,929,117	165,435,780	179,068,281
Otherwise Secured	10,744,089	13,658,082	13,925,080	15,560,851	4,827,689	5,597,834	7,787,758	8,466,897
Unsecured	7,191,351	8,319,291	9,121,341	9,348,762	3,685,106	6,388,835	9,773,541	8,494,993
Allowance	(489,848)	(516,453)	(532,787)	(574,614)	(135,522)	(513,204)	(574,197)	(632,994)
Commercial Loans								
Real Estate Secured	72,116,128	73,284,417	82,642,133	83,519,811	32,485,397	45,379,066	52,441,645	62,297,735
Otherwise Secured	3,932,995	4,783,817	4,575,710	4,162,498	1,270,593	1,062,158	969,430	1,630,913
Unsecured	756,616	771,724	871,550	1,066,319	425,506	253,133	294,374	314,394
Allowance	(1,469,542)	(1,549,357)	(1,598,362)	(1,723,840)	(357,931)	(490,318)	(573,349)	(718,288)
TOTAL LOANS	235,050,924	233,363,532	238,037,315	243,419,328	135,543,031	182,606,621	235,554,982	258,921,931
Accrued Interest on Loans	1,076,633	963,597	971,125	871,336	628,978	716,225	838,438	806,989
Other Assets	4,527,111	4,287,104	5,573,103	5,461,516	2,550,788	2,470,438	5,289,572	3,681,245
TOTAL ASSETS	**286,717,460**	**315,236,589**	**318,323,571**	**314,818,120**	**178,152,706**	**242,234,145**	**306,043,622**	**327,459,473**
LIABILITIES								
DEPOSITS								
Demand	41,568,990	60,743,088	63,065,681	62,953,182	92,728,406	119,812,240	156,741,426	161,032,911
Term	219,468,096	227,873,043	227,643,323	223,603,495	71,113,281	103,295,734	126,184,633	141,781,063
Non-Equity Shares	694,977	592,458	508,550	459,314	-	552,856	1,239,799	1,049,050
Accrued Interest	5,206,648	5,077,079	4,890,578	4,581,669	4,474,276	4,873,363	4,748,010	4,463,208
TOTAL DEPOSITS	266,938,711	294,285,668	296,108,132	291,597,660	168,315,963	228,534,193	288,913,868	308,326,232
Other Liabilities	638,924	487,816	1,178,783	1,368,289	643,699	966,025	1,746,832	1,498,755
TOTAL OTHER LIABILITIES	638,924	487,816	1,178,783	1,368,289	643,699	966,025	1,746,832	1,498,755
CAPITAL								
Equity Shares	2,438,458	2,422,546	2,343,951	2,336,029	772,519	1,031,981	1,554,469	1,585,004
Retained Earnings	16,274,010	17,726,202	18,385,348	19,208,785	8,420,525	11,701,946	13,828,453	16,049,482
Other Primary Capital	427,357	314,357	297,357	212,357				
TOTAL CAPITAL	19,139,825	20,463,105	21,026,656	21,757,171	9,193,044	12,733,927	15,382,922	17,634,486
TOTAL CAPITAL & LIABILITIES	**286,717,460**	**315,236,589**	**318,313,571**	**314,723,120**	**178,152,706**	**242,234,145**	**306,043,622**	**327,459,473**

3.5.1 Financial Soundness and Stability

Two financial ratios that provide an indication of a financial institution's financial health are the liquidity ratio and capital adequacy ratio. The liquidity ratio represents the proportion of deposits held in cash or liquid investments. This ratio indicates the degree to which the financial institution has the ability to meet current demands for funds such as withdrawals, loans and its own short-term debt obligations. The minimum regulatory standard for liquidity for B.C. credit unions is 10%. With liquidity in excess of 20%, both G&F and United far exceed the regulatory minimum. Excess liquidity typically is invested with CUCBC and generates a lower yield than if it were lent out to borrowers. Therefore, while a certain level of liquidity is necessary to reduce risk, excessive liquidity means that these funds are not being effectively deployed and opportunities to generate better returns are being missed.

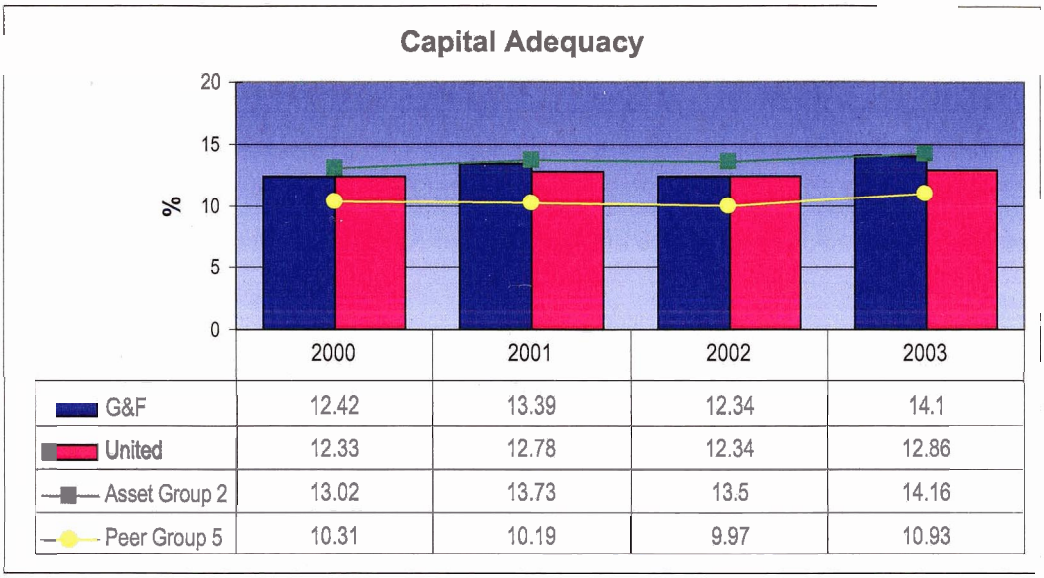
Figure 11: Total Liquidity Ratio (2000-2003)[61]



	2000	2001	2002	2003
G&F	16.77	25.59	24.47	21.88
United	22.96	24.26	21.87	20.4
Asset Group 2	19.04	22.15	22.2	19.87
Peer Group 5	15.69	15.41	14.47	14.74

Figure 11 shows that G&F's liquidity grew between 2000 and 2001 when it peaked, and slowly dropped since then. In early 2001, G&F experienced an increasing rate of growth in its deposit portfolio with no offsetting growth in its loan portfolio. This has contributed to its high liquidity. United also has had high liquidity over this period and has been gradually reducing it, bringing it more in line with Asset Group 2. Liquidity for Peer Group 5 has been fairly stable at around 15%.

Figure 12: Capital Adequacy Ratio (2000-2003)[62]



	2000	2001	2002	2003
G&F	12.42	13.39	12.34	14.1
United	12.33	12.78	12.34	12.86
Asset Group 2	13.02	13.73	13.5	14.16
Peer Group 5	10.31	10.19	9.97	10.93

The capital adequacy ratio is the financial institution's capital expressed as a percentage of its risk-weighted assets. Minimum levels of capital adequacy are established by FICOM to ensure that the financial institution is able to absorb a reasonable level of loss without risk of insolvency. The minimum set in the *Financial Institutions Act,* which applies to B.C. credit unions, is 8%. By setting minimum capital adequacy standards, depositors are protected and the stability and efficiency of the financial system is maintained. Therefore, greater capital adequacy provides greater protection for depositors. Figure 12 indicates that United's capital adequacy has been relatively stable over the last four years and G&F's has been slightly less stable. Both credit unions have a significantly stronger capital base than the average of the larger credit unions in Peer Group 5 yet not as strong of a capital base as that of Asset Group 2.

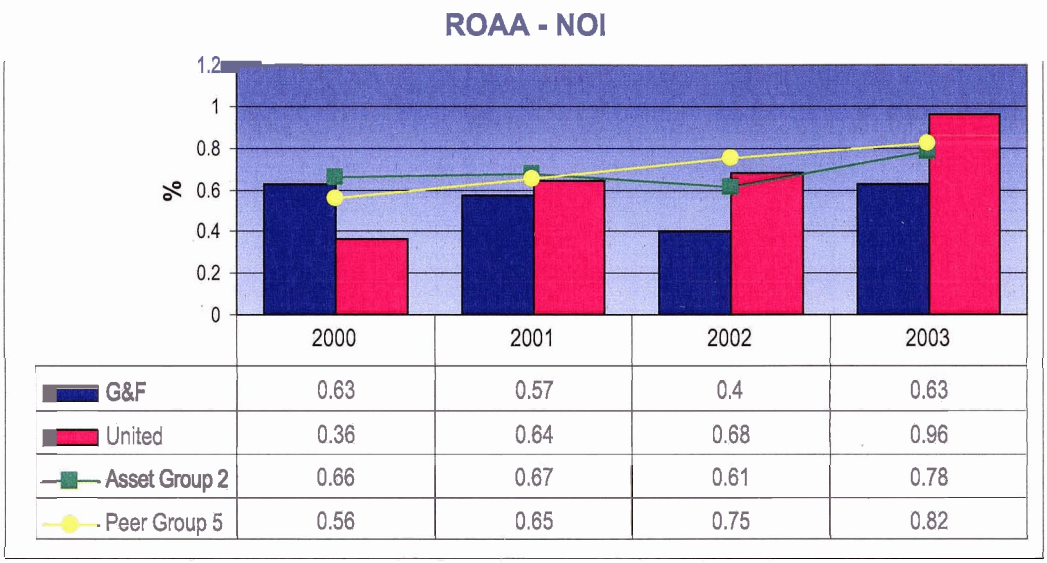
Retained earnings as a percentage of assets has increased from 2000 to 2003 for both credit unions. G&F's retained earnings as a percent of assets grew from 5.7% to 6.1% during this period and United's retained earnings grew from 4.7% to 4.9%. Although G&F shows better performance than United in this area, United tends to return more of its profits back to its members through patronage rebates and its profit sharing account. However, the increase in retained earnings indicates an ability for the credit union to fund growth and capital investments, such as branch expansions.

3.5.2 Profitability

3.5.2.1 Return on Average Assets

The return on average assets is calculated using net operating income (ROAA-NOI) representing before tax and dividends/distributions to members, and net income (ROAA-NI) which is after tax and dividends. Credit unions vary in the degree to which they provide dividends to members; therefore, ROAA before taxes and dividends (ROAA-NOI) is the better ratio for comparison across credit unions.

Figure 13: Return on Average Assets-Net Operating Income (2000-2003)[63]



	2000	2001	2002	2003
G&F	0.63	0.57	0.4	0.63
United	0.36	0.64	0.68	0.96
Asset Group 2	0.66	0.67	0.61	0.78
Peer Group 5	0.56	0.65	0.75	0.82

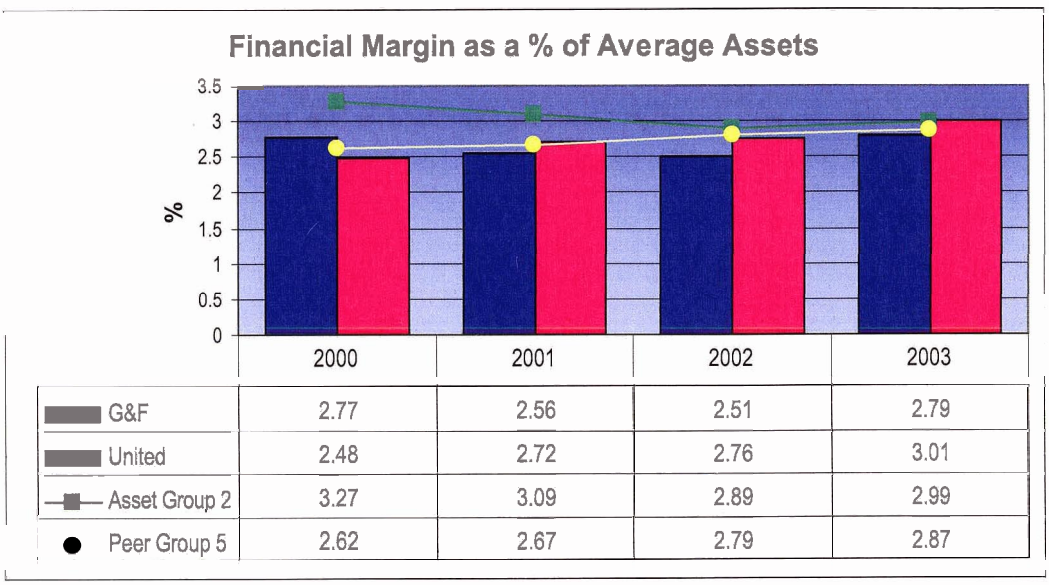
Figure 13 shows that during 2000, G&F's ROAA-NOI surpassed that of both Peer Group 5 and United. However, G&F's ROAA-NOI declined in 2001, the first of three years where its ROAA-NOI severely trailed these comparators. Its 2003, results show a reversal of its downward trend, but its performance still trailed that of these comparators, which have experienced continuing improved profitability. After dropping to 40 basis points in 2002, by the end of 2003, G&F had recovered to its 2000 level ROAA-NOI of 63 basis points

United's ROAA-NOI has shown tremendous improvement since 2000 when its ROAA-NOI was 36 basis points. It ended 2003 with ROAA-NOI at 96 basis points. Over the last four years, it has improved its ROAA-NOI such that it surpassed the average of Asset Group 2 by the end of 2002 and that of Peer Group 5. Results for 2004 show United outperforming both comparator groups.

3.5.2.2 *Financial Margin*

Financial margin has increased over the four-year period for both of these credit unions. While some of this margin is due to differences in the rates charged on loans and rates paid on deposits, decreasing liquidity also contributes to increasing margin.

Figure 14: Financial Margin as a % of Assets (2000-2003) [64]



G&F's high and increasing liquidity starting in 2001 lead to decreasing margins for the credit union. Although the loan portfolio increased in 2002 by just over 2.0%, margins continued to decline in 2002 with recovery noted in 2003. However, in the three year period, 2001 to 2003, G&F underperformed relative to United and the comparator groups. In contrast, United's financial margin has steadily improved over the four-year period. The gap between United's financial margin and that of Asset Group 2 and Peer Group 5 has been narrowing since 2002, and it ended 2003 with higher performance than these comparators. Although United has also maintained high liquidity levels over this period, its greater margins suggest that it has performed better in managing its interest rate structure and non-financial expenses, thereby generating margins equivalent to the comparator groups.

Table 7: Financial Margin (2000-2003)

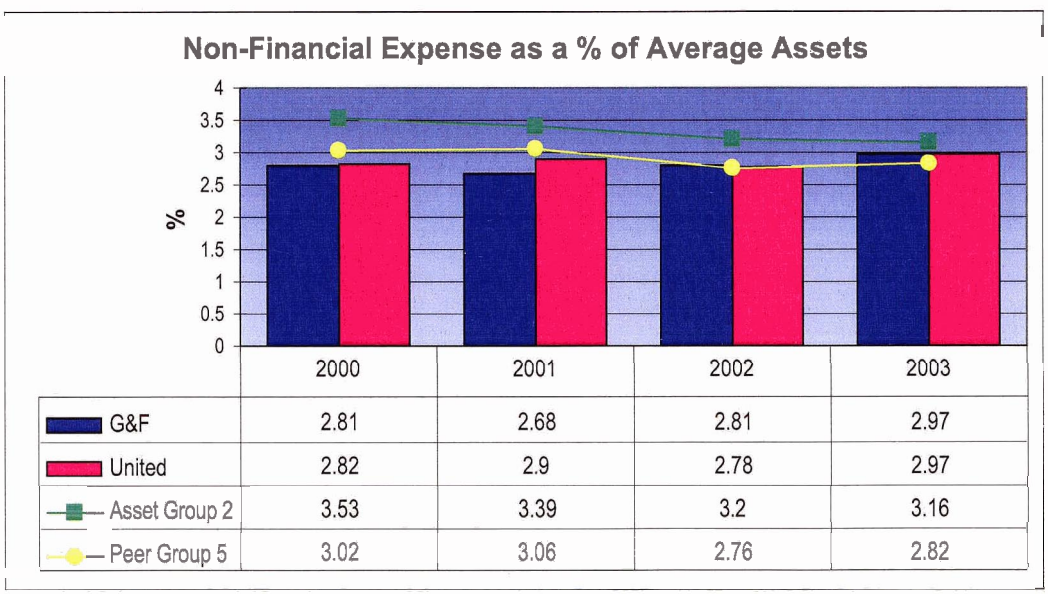
	G&F 2000	G&F 2001	G&F 2002	G&F 2003	United 2000	United 2001	United 2002	United 2003
Performance Statisitics								
Financial Margin	40%	39%	45%	51%	37%	43%	54%	57%
% Increase in Financial Margin	5.9%	-1.9%	16.3%	12.5%	-1.2%	15.9%	26.0%	5.0%

The financial margin data in Table 7 represents each credit union's effectiveness in employing its assets to generate interest income. United experienced a steady increase in its financial margin over this four year period with G&F experiencing a steady increase in its margin relative to its 2000/2001 levels.

3.5.2.3 Non-Financial Expense as a % of Average Assets (2000-2003)

Non-financial expenses are all expenses, excluding interest expense, and represent the operating expenses of the credit union. Both United and G&F have performed fairly well relative to the comparator groups. Presenting non-financial expense as a percent of average assets provides a clearer picture of the trend in these expenses relative to the size of the credit union. Although G&F and United have slipped relative to Peer Group 5, most notably in 2003, they both outperform the average of Asset Group 2, and marginally trail that of the larger credit unions in Peer Group 5. Considering Peer Group 5 credit unions have the opportunity to achieve greater economies of scale due to their size, both United and G&F are either performing extremely well in managing their expenses relative to their assets, or the Peer Group 5 credit unions are under-performing in this category.

Figure 15: Non-Financial Expense as a % of Average Assets (2000-2003)[65]



	2000	2001	2002	2003
G&F	2.81	2.68	2.81	2.97
United	2.82	2.9	2.78	2.97
Asset Group 2	3.53	3.39	3.2	3.16
Peer Group 5	3.02	3.06	2.76	2.82

3.5.2.4 Operating Efficiency Ratio

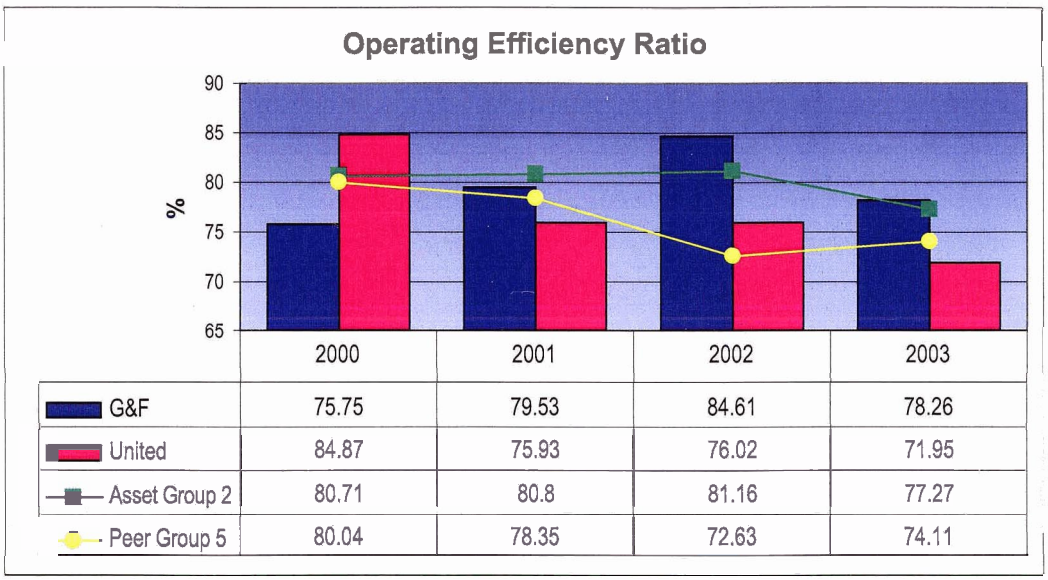
In the financial services industry, a key performance indicator is the operating efficiency ratio, also referred to as the productivity ratio. This ratio indicates the overall efficiency of the

financial institution and represents non-financial expenses as a percentage of the sum of financial margin and non-financial income. A lower ratio indicates higher productivity.

In 2000, G&F's operating efficiency was superior to these comparators, but saw a rapid decline in its operating efficiency in 2001 and 2002 when its operating efficiency peaked at 84.61%. Prior to 2000, however, G&F's operating efficiency was considerably higher than the 75.75% low achieved in 2000. The dramatic shift in operating efficiency is explained by events related to its 1999 merger discussions with several other large credit unions (Surrey Metro and Richmond Savings). During these discussions, G&F determined that it needed to cut costs and undertook a major cost-cutting program. In 2000, G&F cut $700,000 of non-financial expenses, much of it achieved by reducing staff from 80 full-time equivalents to 69 full-time equivalents.

However, after the talks broke off, G&F increased its staff complement such that by 2002, it was back up to 79 full-time equivalents, many of which were higher skilled employees receiving higher compensation levels than those laid off. This, along with an increase in incentive compensation payouts, contributed to the 13.5% increase in salary and benefit costs in 2002 over 2001. Another factor contributing to the increase in non-financial expense was the increase in "Other Expenses" (marketing, general and administrative, legal, and miscellaneous). Other expenses increased by 20.9% and 10.5% in 2001 and 2002 respectively. Some of this increase was due to an increase in marketing expenditures related to branding initiatives. Limited growth in combined financial margin and non-financial income further eroded the operating efficiency during 2001/2002. Although, non-financial expenses appear to have only recently jumped, in reality, these expenses are returning to their pre-cost cutting level of non-financial expense.

Figure 16: Operating Efficiency Ratio (2000-2003)[66]



United's operating efficiency has improved over the last four years. In 2002, when United merged with Allied, Allied's operating efficiency was 140.42%. Considering Allied's poor performance in this, and many other areas, United quickly recovered from the burden of Allied's inefficiency and continued to enhance its own efficiency. United's improving operating efficiency ratio is likely due to the increased scale efficiency that has been achieved through the mergers, thereby reducing its non-financial expense as a percent of average assets, and increasing its income relative to average assets, most notably, non-financial income.

Table 8: Operating Efficiency Ratios (2003)

Financial Institution	2003 Operating Efficiency Ratio
G&F	78.26%
United	71.95%
Scotiabank (Domestic Banking)[67]	61.5%
Scotiabank (Worldwide)[68]	54.9%
TD Bank (Commercial and Personal Banking)[69]	58.8%
CIBC (Domestic Banking)[70]	62.4%
CIBC (Overall Consolidated)[71]	70.2%

Although United has achieved an efficiency ratio better than the average of Peer Group 5, it lags the chartered banks in terms of operating efficiency. For example, the 2003 operating efficiency ratio of Scotiabank, one of the top performing Canadian chartered banks, was 54.9%

for its worldwide operations and 61.5% for its domestic banking operations. CIBC reported a 2003 operating efficiency ratio of 62.4% for its Canadian retail banking markets and 70.2% for its overall consolidated operations. Considering United's smaller size, its 2003 operating efficiency ratio of 71.95% compares well to that of these Schedule I banks. The challenge for post-merger G&F is to continue to improve its operating efficiency and narrow the gap between itself and the banks

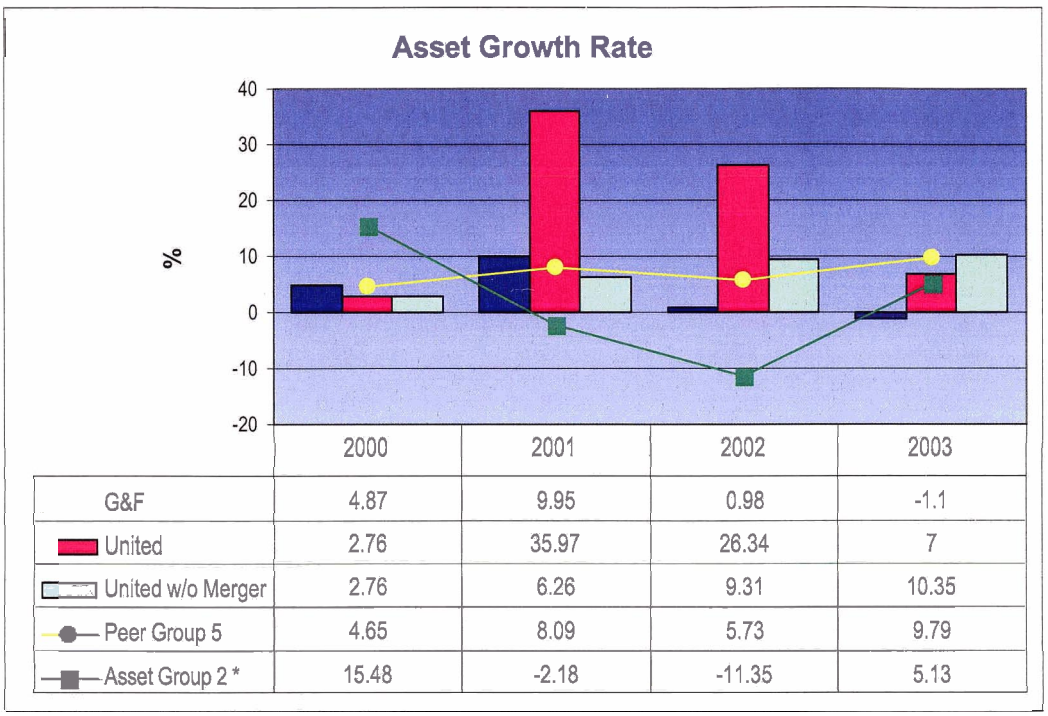
3.5.3 Growth

3.5.3.1 Asset Growth

The primary measure of growth in this industry is the asset base, which is largely comprised of the loan portfolio. Figure 17 illustrates the year over year asset growth and highlights United's considerable growth in assets when it merged with Burnaby Savings in 2001 and Allied in 2002. In 2003, United's asset growth rate exceeded Asset Group 2 and Peer Group 5. With virtually no growth in assets over the last two years, G&F's rate of growth is below that of both United and the comparator groups. (The negative growth for Asset Group 2 is due to migration of credit unions from this asset group to another asset group and, therefore, is not a reliable comparator on this measure.)

From 2001 to 2003, the total asset growth for G&F was 15.2%. United's total asset growth over this same period was 88.9% including the assets from mergers and 32% when merger assets are excluded. When the assets from the two mergers are excluded, United's growth rate trailed G&F in 2001. In 2002 and 2003, United's asset growth surpassed that of G&F, which experienced less than 1% growth in 2002 and a decrease in assets in 2003.

Figure 17: Asset Growth Rate (2000-2003)[72]

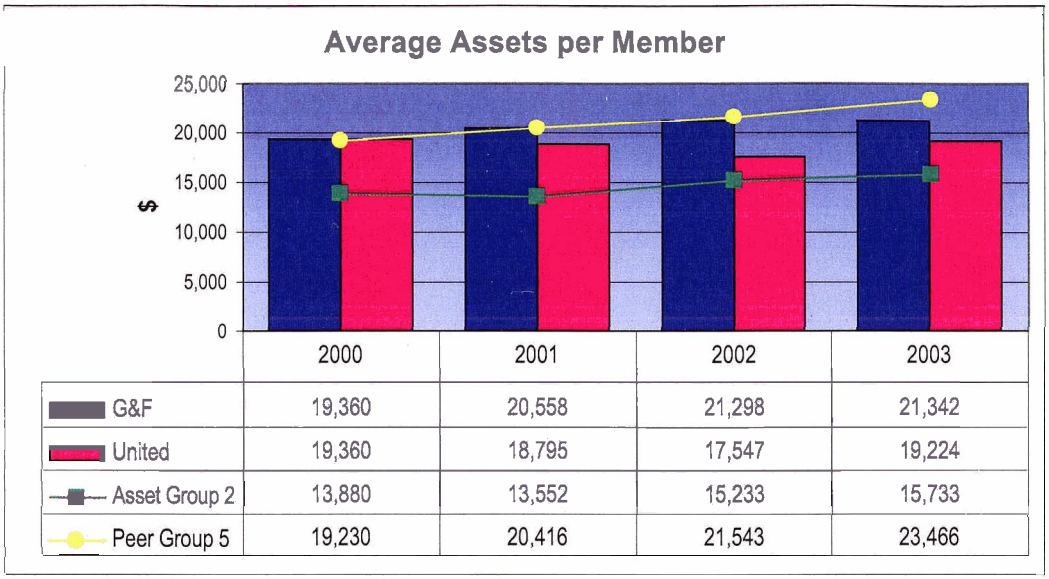


	2000	2001	2002	2003
G&F	4.87	9.95	0.98	-1.1
United	2.76	35.97	26.34	7
United w/o Merger	2.76	6.26	9.31	10.35
Peer Group 5	4.65	8.09	5.73	9.79
Asset Group 2 *	15.48	-2.18	-11.35	5.13

** The dramatic decline for Asset Group 2 reflects credit union migration out of this asset group.*

Despite G&F's struggle with asset growth, it has increased its average assets per member (Figure 18), which is likely attributed to some reduction in members and the increased volume of commercial lending, which tends to be higher value loans per member. United's assets per member dropped with each merger, but shows recovery in 2003.

Figure 18: Average Assets Per Member (2000-2003)[73]

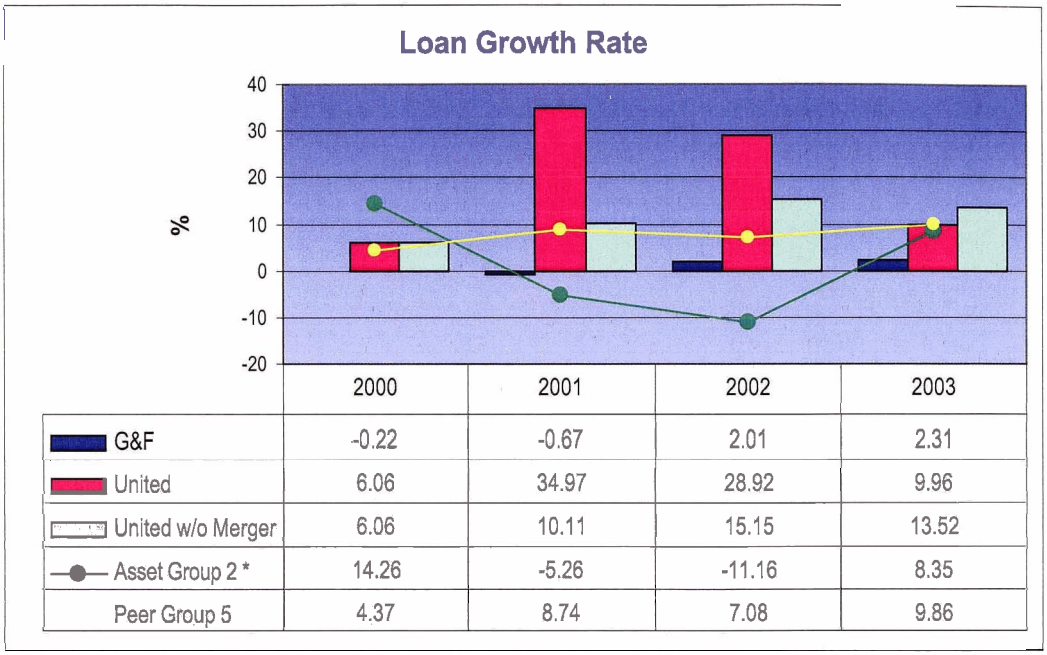


	2000	2001	2002	2003
G&F	19,360	20,558	21,298	21,342
United	19,360	18,795	17,547	19,224
Asset Group 2	13,880	13,552	15,233	15,733
Peer Group 5	19,230	20,416	21,543	23,466

3.5.3.2 Loan Growth

Figure 19 below compares the rate of growth in the loan portfolio for United, G&F, Peer Group 5, and Asset Group 2. Again, the chart in Figure 19 clearly illustrates the considerable growth achieved by United from its merger in 2001 with Burnaby Savings and 2002 with Allied Savings. From 2001 to 2003, United's organic rate of growth of its loan portfolio has exceeded that of Peer Group 5 and Asset Group 2. United's loan portfolio grew 91% over the last three years (2001 to 2003) including the transferred-in loans from the mergers, and grew 44% over this period after excluding the Allied and Burnaby loan portfolios. Most of the organic growth is due to growth in residential mortgages. As a percent of average assets (Figure 20), United's loan portfolio has increased since 2001, but has been declining since it peaked at 87% in 2001.

Figure 19: Loan Growth Rate (2000-2003)[74]

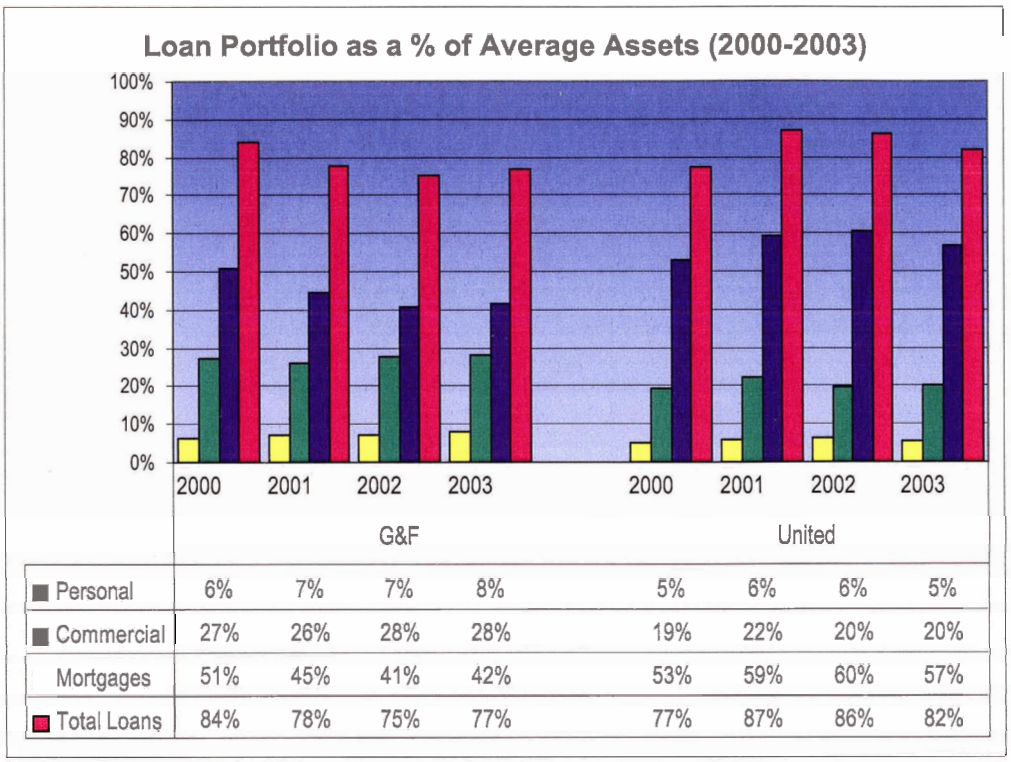


	2000	2001	2002	2003
G&F	-0.22	-0.67	2.01	2.31
United	6.06	34.97	28.92	9.96
United w/o Merger	6.06	10.11	15.15	13.52
Asset Group 2 *	14.26	-5.26	-11.16	8.35
Peer Group 5	4.37	8.74	7.08	9.86

** The dramatic decline for Asset Group 2 reflects credit union migration out of this asset group.*

Over the last four years, G&F has experienced limited growth in its total loan portfolio or across individual lending categories. As a percent of average assets, G&F's loan portfolio has decreased, with most of this related to a decline in residential mortgage business. G&F lost many mortgages due to not offering a variable rate mortgage for its members. In early 2003, G&F introduced a variable rate mortgage product that has lead to some recovery in this area. Commercial lending as a percent of average assets has remained stable for G&F, and personal loans have increased a small amount.

Figure 20: Distribution of Loan Portfolio – G&F and United (2000-2003)[75]

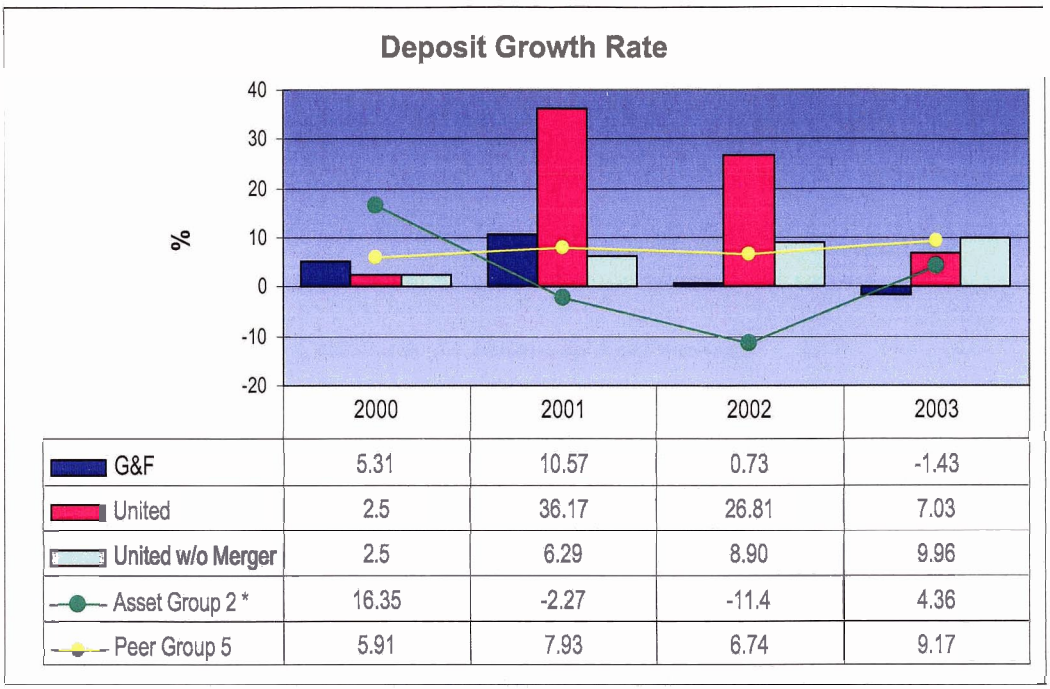


	G&F				United			
Personal	6%	7%	7%	8%	5%	6%	6%	5%
Commercial	27%	26%	28%	28%	19%	22%	20%	20%
Mortgages	51%	45%	41%	42%	53%	59%	60%	57%
Total Loans	84%	78%	75%	77%	77%	87%	86%	82%

3.5.3.3 Deposit Growth

Figure 21 illustrates a similar trend as loan and asset growth; however, G&F's deposit growth has been rather erratic over the last four years. With 21.9% liquidity, there is little need for G&F to grow its deposit portfolio, especially when it appears to have no increase in demand for loans. United's deposit portfolio growth without merger assets has steadily increased, just slightly outpacing its rate of loan growth. Relative to its comparators and G&F, United lagged in both 2000 and 2001, but in 2002 and 2003, its deposit growth rate exceeded that of these same comparators.

Figure 21: Deposit Growth Rate (2000-2003)[76]



	2000	2001	2002	2003
G&F	5.31	10.57	0.73	-1.43
United	2.5	36.17	26.81	7.03
United w/o Merger	2.5	6.29	8.90	9.96
Asset Group 2 *	16.35	-2.27	-11.4	4.36
Peer Group 5	5.91	7.93	6.74	9.17

** The dramatic decline for Asset Group 2 reflects credit union migration out of this asset group.*

3.5.4 Financial Performance of Subsidiary

An important element of the credit union's portfolio is off balance sheet assets. Off balance sheet assets are those funds that are administered by the credit union and generate revenue, but not held or controlled by the credit union. Funds that members invest into mutual funds or stocks through the credit union and its subsidiary are an example of off balance sheet assets. These can be a significant source of revenue for the credit union.

Table 9: Subsidiary Earnings (2000-2003)

	G&F 2000	G&F 2001	G&F 2002	G&F 2003
Subsidiary and Other Equity Investment Earnings - Net	-$827	-$58,780	-$116,942	-$96,906

In 2002, the wealth management subsidiary had approximately $18 million in funds under administration. This amount is now approximately $52 million and the merged credit union administers another $12 million of investments through retail banking operations. Separate financial statements were not available for G&F's subsidiary; however, Table 9 shows that the subsidiary has not yet had a positive impact on the profitability of the credit union. Anecdotal information is that 2003 was the first the year that the insurance subsidiary did not lose money and that the performance in 2004 for the wealth management area "shows promise."

Although the 2003 loss of nearly $100,000 is attributed to the wealth management subsidiary, the financial reporting for the subsidiary does not accurately portray its true income potential. First, a considerable portion of this loss is due to a "bad compensation contract," established with the Financial Planners, which is costing G&F $80,000 per year more than expected. These contracts do not expire until December 2005. Second, because the subsidiary is taxed at the corporate income tax rate, and the credit union is taxed at the small business tax rate, the credit union aggressively transfers reasonable expenses from the credit union to the subsidiary.

3.5.5 Concluding Comments on Financial Performance

The high levels of liquidity and capital adequacy of both G&F and United indicate that they are financially stable and healthy credit unions. However, the trend data shows that G&F has struggled in recent years with limited loan growth, excess liquidity, declining financial revenues and volatile expense control. All of these factors have contributed to reduced margins and declining operating efficiency from 2001 through to 2002 with some recovery noted in late 2003. Overall the financial performance of G&F showed signs of deterioration during a period when comparator groups were generally experiencing improved financial performance. The financial performance seems indicative of a lack of attention to managing the business. In addition, the increased focus on the wealth management subsidiary is not yet compensating for the floundering retail banking performance.

United clearly benefited from the Allied and Burnaby Saving mergers. Profitability and operating efficiency have steadily improved and, in addition to the growth acquired through the mergers, the credit union has achieved considerable organic growth.

4 ISSUES

The findings of the industry analysis and review of consumer behaviour highlighted some issues that are not unique to G&F, but to all firms in the financial services industry. These issues are increased competition, particularly from non-traditional retail banking firms, and general dissatisfaction of consumers with the financial services industry. The internal analysis highlighted a number of issues specific to G&F – strategic focus and branding, the role of human resources in achieving competitive advantage, balancing merger implementation activities with operational activities, and future merger direction.

4.1 Impact of External Factors

4.1.1 Competition

The industry analysis highlighted the various sources of competition that this industry faces. The regulatory environment is encouraging increased competition and making it easier for firms from other industries and foreign competitors to enter this market. Specialty service providers such as brokers and payday loan companies are carving out their niche. Advances in technology enable firms to enter this market with a lower cost structure than that of a traditional bricks and mortar retail banking operation. All of these factors provide consumers with greater choice and put increased pressure on traditional retail banking firms to become more efficient.

In order for G&F to compete effectively in this market, it must seek ways to differentiate itself from its competitors. While differentiation can provide opportunities to charge a premium price, differentiation will not support a large spread in prices to support a higher cost structure, therefore, G&F must also continue to improve its operating efficiency. Investment in technology that will improve decision-making and reduce staff time will not only reduce costs and improve turnaround times, but free staff up so that they may focus on serving members. As a small financial institution, G&F is unable to compete using a cost-based strategy and, therefore, must be able to differentiate itself from its competitors. Since products and e-channels are generally non-differentiable and highly imitable, the greatest opportunity for differentiation in this industry is through in-branch service delivery.

4.1.2 Consumer Behaviour and Attitudes

Data from a variety of surveys show that both credit unions and banks are failing to meet the service expectations of consumers. With the increased options available to consumers and competition for market share, G&F will need to work harder to satisfy members and meet their expectations. Consumers have become more sophisticated and, with the internet, have access to

considerably more information on products and rates than they had in the past. Further, they need not even leave their computers to conduct a variety of transactions and open accounts with new financial institutions. With electronic banking, it is very manageable for a consumer to have accounts at multiple institutions; loyalty is largely a thing of the past. With the increased convenience and adoption of electronic banking, consumers have little need to go into a branch. Although the average electronic transaction cost is much lower than a human processed transaction, the disadvantage of electronic transactions is that the financial institution has limited ability to build relationships with consumers and get more of their business.

With the average age of G&F's members being greater than the population of the GVRD, G&F may be somewhat insulated from the impact of electronic banking and the internet due to the slower adoption of technology by older people. However, G&F cannot ignore the impact of technology on attracting and retaining younger members, who also tend to be less loyal than older members. The under-representation of younger people among its membership is an issue that requires closer examination. Without more young members, G&F may find itself with a rapidly declining membership in the next ten years as its aging members begin to pass on and their wealth is transferred out of the credit union.

4.2 Internal Issues

4.2.1 Strategic Focus

A primary issue that seemed to permeate throughout the internal analysis was that of strategic focus. Prior to the merger, G&F's strategic focus was to build its wealth management services. The vision was that wealth management services would become G&F's primary business, and retail banking would be secondary. In recent years, G&F's focus was on building its credibility and reputation in providing wealth management services. United, however, has only recently stepped into the wealth management arena. United demonstrates a clear commitment to growing its retail banking structure, with wealth management a supplementary service offering.

What the future focus will be is still undecided. Without knowing the future vision and supporting business strategy of the credit union, managers and executives are immobilized and unable to develop strategies to support it. Without a strategic focus and vision, staff may find it difficult to adapt to the changes that they are experiencing, particularly if they are resentful about the changes they are experiencing.

4.2.2 Impact of Merger Implementation

It appears that immersion in merger implementation activities has tended to detract attention from on-going operational activities. The magnitude of activities involved with managing and implementing the integration of two firms is significant and places considerable pressure on staff resources. However, it is important that G&F isolate the impact of merger implementation activities from on-going operations. For example, in recent years, United's marketing activities have focused on merger related activities, leaving limited resources, financial or human, to develop and implement marketing strategies. While operations appear to be maintained effectively during a merger implementation, activities that could advance the credit union's competitive positioning and strength may not be receiving adequate attention.

4.2.3 Strategic Fit

As smaller financial institutions with limited resources, both United and G&F undertook a cost-based approach to many activities, yet had a generic strategy to differentiate based on product and service quality. Since the merger, activities still tend to have a cost-based approach; however, many activities are shifting toward a differentiation approach. Overall, the activities of G&F leave it dangling between the two strategies – cost-based and differentiation – albeit leaning more heavily toward a cost-based approach. The focus on a cost-based approach in the past, particularly by United, has compromised the ability of each of these two credit unions to differentiate themselves from other financial institutions, particularly other credit unions. The cost-based approach has been integral to the successful merger growth and financial performance of United; however, continued focus on a cost-based approach will compromise the merged entity's ability to compete effectively in this market.

4.2.3.1 Sales and Service, and Human Resources

Although improving operating efficiency through growth and cost management is important, the credit union must continue to deliver value to its members to retain current business and attract new business. Although members rate the credit union very high on its service levels, the credit union needs to continue to develop its competence in this area so that it can extract greater value from these relationships, and reduce the incidence of negative experiences for members (e.g. long line-ups). As a virtual unknown (i.e. not a credit union and not a bank) among a variety of established financial service providers, G&F will need to stand out in terms of its service levels and level of staff competence in order to attract new members.

A key determinant of service quality is the effectiveness of the investment made in human resources. While the credit union offers compensation and benefits to its employees that are among the highest of B.C. credit unions, it has been remiss in attending to the effectiveness of this investment and ensuring that it is providing value to the credit union. This is evidenced by the under-investment in the human resources function both pre- and post-merger. Not only is the function inadequately staffed to take care of day-to-day operational needs, the fact that both credit unions had weak human resources management processes, programs, policies and systems means that a human resources program needs to be built from the ground up. In addition, there are numerous issues to be addressed related to merger integration such as staff training on new systems, products and procedures, and change management activities.

The above addresses issues to get the human resources function "caught up," but has not begun to address the strategic role of human resources. By linking the role of human resources to the business strategy, the credit union has the opportunity to leverage its employees as a source of competitive advantage. For example, by understanding the long-term goals of the credit union, the human resources function is able identify skills needed in the future, and gaps in current skill sets. Human resources can then develop strategies to ensure that the credit union has people with the skills needed to achieve the credit union's long-term business objectives.

Unfortunately, the underdevelopment of the human resources function will continue to hold G&F back from capitalizing on the potential of its employees to enhance G&F's performance. The savings from operating a lean human resources function will be short-lived. Due to inadequate funding and staffing to maintain this function, G&F is now faced with the high costs of building this function from the ground up. The longer it delays investment in its human resources function, the larger the magnitude of the catch up activities and the longer this function will operate inefficiently and ineffectively.

4.2.3.2 Marketing Focus

As mentioned earlier, merger activities have a tendency to detract resources from on-going operations. Marketing has been one of those areas for United. Prior to the merger, G&F focussed on building the G&F brand and promoting its financial planning services. For the next year, the focus and priority is on merger implementation issues, therefore, activities related to branding and promoting financial planning services will be subordinate. Given that there has been no decision as to the respective roles of wealth management and retail banking in the credit

union's long-term plan, a marketing strategy may be premature, but this emphasizes the need for decisions regarding the strategic focus of the credit union.

In the past, each of these credit union's marketing activities has been somewhat scattered and inconsistent with the stated objectives. For example, G&F spoke of increasing share of wallet of existing members, and going into wealth management as a defensive strategy to protect its deposit base. However, the decision to change its name was largely based on non-members' perceptions of the name, "Gulf and Fraser Fishermen's Credit Union," and the lack of credibility of credit unions and fishermen in providing sound financial advice. United generated a large volume of brochures, flyers and newsletters that were distributed in member statements and via mail drops. Given the limited resources, both credit unions' activities were driven by costs and the skills available in-house. With the combined resources of the two credit unions, G&F may be able to undertake marketing activities that are more strategic, rather than tactical, in nature and also be able to outsource those marketing activities in which G&F does not demonstrate a core competence.

The pre-merger marketing activities of each of these credit unions also demonstrate a lack of focus in the markets they were targeting for development. Pre-merger marketing activities of G&F tended to target a market that it did not have the necessary core competencies to serve effectively, and United's pre-merger marketing activities were more of a shotgun approach. Although the funds available for marketing are now greater than each credit union had individually, it is imperative that it allocate its marketing funds to development of those markets where there is the greatest potential for profitable growth.

G&F and United have both faced declines in membership. While building share of wallet is important, a steady stream of new members is also important for future viability of the credit union. With a greater proportion of members aged 55 and over than that of the population of the GVRD, G&F may experience a continued decline in membership as the older members pass on and fewer new members join the credit union. In addition, the under-representation of younger people means that the credit union is missing opportunities to serve a market in its prime borrowing years. Although the credit union emphasizes member retention on the basis that it is less costly to retain a member than attract a new member, this approach fails to consider the lifetime value of the member. That is, there is greater value to attracting and building loyal members when they are 35 years of age than when they are 55 years of age.

Another issue that will pose some challenges for G&F is the disassociation from the credit union brand. While credit unions may not have the same level of perceived credibility as a

large investment house, for the most part, people are familiar with credit unions and view credit unions as a viable alternative to banks. By eliminating references to "credit union," G&F Financial Group is not associated with anything and, therefore, it may struggle to build its identity and reputation. As an unknown "financial group," it may still suffer from lack of credibility. The lack of familiarity with the G&F name in Port Coquitlam and Surrey may affect the ability for these branches to attract new members. Establishing an identity will require considerable energy and resources.

4.2.4 Core Competencies

G&F's competencies tend to exist in support activities versus primary activities. The competencies in financial management and merger integration support a growth, low cost strategy, but do not provide a basis on which the credit union is able to differentiate itself from other financial service providers. Merger integration competency is not something that members knowingly experience and value; however, they will notice incompetence. Although merger integration competency is critical for the credit union's merger strategy, this competency does not enable G&F to differentiate itself from its competitors in the eyes of the consumer, nor does this competency have the same value when not being used.

In terms of primary activities, G&F has developed few core competencies. Commercial lending is the one exception as it has demonstrated expertise in this area. Member services is an area in which the credit union has some strength, but its level of competence here does not surpass that of other credit unions. The ability for member services to develop into a core competency will be constrained by the weakness in the human resources function, and to the degree that the sales and service strategy is hindered by a lack of strategic focus and vision. For the most part, the credit union is competent in the primary activities, but does not excel in any of the areas except commercial lending. As a result of the generalist functions in both credit unions in the past, both have become quite good at many things; however, to develop core competency in any of its primary activities, the credit union may be challenged with a lack of depth in many of its positions.

4.2.5 Future Merger Direction

With few viable potential merger partners remaining in the lower mainland, G&F cannot be too particular about the credit unions with which it will merge. Ideally, if G&F was blessed with many choices, it would identify those credit unions whose strengths could offset G&F's areas of weakness. For example, a merger with a credit that has a strong human resources

function or well-developed sales and service strategy and culture would complement G&F's competencies. Unfortunately, the viable partners are smaller than G&F and generally have similar weaknesses. Since the potential partners also lack strength in G&F's areas of weakness, it is even more critical that G&F address issues around human resources, sales and service, and marketing, as G&F will be unable to acquire these competencies through future mergers. Should the credit union find itself with an opportunity to merge prior to addressing some of these issues, the issues will continue to grow and become even less manageable to address.

4.2.6 Concluding Comments

G&F has achieved considerable success in achieving growth through mergers and in improving its operating efficiency and overall financial performance. However, the merger implementation activities have consumed extensive resources, thereby leaving little available to develop the overall strength of the credit union so that it is able to support future growth and become a stronger competitor. A significant gap is that of a lack of emphasis in understanding member's needs and in implementing systems necessary to delight existing member and attract new members. This is evidenced by the lack of strength in almost all of the primary activities that "touch" the member, and in the support activities that directly impact the development of competence in the primary activities, namely human resources and employee development.

5 RECOMMENDATIONS

In response to the issues identified, the following discusses a number of recommendations that will enable G&F to achieve greater strategic fit, and enhance its competitive advantage. Although the recommendations are presented separate from one another, there tends to be linkages between them. Therefore, the value of implementing any one recommendation is enhanced by implementing the other recommendations.

5.1 Development of Business Strategy

The most critical action that must be undertaken is the development and communication of a business strategy that is separate, and distinct, from that of the "growth through merger" strategy. This is necessary to guide decisions and the development of supporting business strategies in the functional areas. In the absence of a common understanding of the business strategy and vision, the likelihood of people working toward incongruent goals is increased. It is particularly important that the Board and executive define the role of wealth management and retail banking in the business strategy as there currently is not a common understanding in this regard. Defining the credit union's core business – wealth management or retail banking – and the respective roles of wealth management and banking, will also enable the credit union to define who its customers are, its marketing strategy and the competencies needed to succeed in that business.

5.1.1 The Role of Wealth Management

Although this review did not undertake a comprehensive analysis of the wealth management industry to determine the magnitude of the opportunities available, the internal analysis does not support pursuit of a strategy whereby retail banking is supplementary to wealth management. To succeed in wealth management as its primary business, G&F would have to overcome many barriers. G&F's management expertise and knowledge is in the retail banking industry, not in wealth management. G&F is an unfamiliar entity to non-G&F members and its disassociation with the credit union system means that it will need to build its own reputation and identity. This will take time as G&F can only build its credibility in the wealth management market through demonstrated competence. The resources necessary to build wealth management as its core competence and primary business would be considerable.

Although there are gaps in the competence of G&F in wealth management, wealth management does play a valuable role in rounding out G&F's product and service offering. However, to deliver these services competently and effectively as part of its product and service

portfolio, G&F still must invest in developing its capabilities in this area. In addition to the fact that the subsidiary's performance has been less than stellar, there currently is no clearly defined model or strategy for the delivery of wealth management services. It is advisable the G&F hire outside expertise to assist in developing a wealth management strategy and an implementation plan. While G&F could consider outsourcing some functions such as order processing, compliance and management activities, G&F is of sufficient scale to cost effectively carry out these activities in-house once it develops its competence in these areas.

Related to the role of wealth management is the role of the insurance subsidiary in terms of providing a competitive advantage. The expertise required to operate an insurance subsidiary is different from that required to manage retail banking operations. To date, the insurance subsidiary has not provided any significant financial value to the organization. This is likely due to the credit union not having insurance management knowledge and expertise and, therefore, the agency does not receive the attention it needs to prosper. In the absence of a strategic rationale that supports keeping this business, G&F should either sell the insurance agency or consider a management services contract. A number of credit unions have partnered with CUMIS such that CUMIS provides professional agency management competence, and the credit union is able to capitalize on the scale efficiencies and buying power of CUMIS.

One of the issues that the credit union faces with achieving credibility is the fact that in-branch Investment Advisors and the Financial Planners in the subsidiary do not support each other. When the Financial Planners denigrate the investments members make with in-branch Investment Advisors, the Financial Planners affect the credibility of the wealth management services of the entire credit union. While part of this is due to different service providers for the subsidiary and the branch, some of this may be due to poor integration of these services, and some of it due to lack of lack of emphasis on the complementary, not competitive, roles of these services. Ideally, G&F should consider moving to one service provider to reduce this conflict. However, G&F believes that there are advantages with having these two service providers, therefore, the credit union should consider whether the value that each service provider offers offsets the potential tension and conflict created. If a service provider is offering inferior products and services, then G&F should seek an alternative service provider.

Regardless of the decision with regard to service providers, G&F should identify ways to break down the silos and conflicting efforts of the in-branch Investment Advisors and Financial Planners. If the in-branch Investment Advisors are providing poor advice, then G&F must either

provide greater training to develop their competence, or hire individuals with greater skills into these positions.

5.1.2 The Role of Retail Banking

G&F's management expertise and knowledge is in the retail banking industry, not in wealth management. Systems, process and competencies all support retail banking. Contrary to the doom and gloom forecast in the late 1990's regarding the future of retail banking, the retail banking industry continues to generate profits. In addition, the pre-merger performance of both of these credit unions demonstrates that it is possible for small financial services institutions to compete profitably in this market, particularly if they are effective in improving their operating efficiency and deliver value to the consumer. G&F's strength and rigour in monitoring and managing financial performance and banking operations provides it with a solid foundation on which to build the other competencies it needs to compete more effectively. (These competencies are discussed later in this section.)

5.1.3 Affiliation with the Credit Union System

Another source of strength for both of these credit unions has been their affiliation with the credit union system. Although some non-credit union members may perceive the products and services of credit unions as inferior to that offered by banks, consumer research shows that consumers tend to view credit unions more favourably than banks, and they consider credit unions as viable alternatives to banks.

To the degree that a brand is recognized, it reduces the consumer's search cost and risks – perceived and psychological. G&F does not achieve these benefits associated with the credit union brand. Further, the costs related to re-branding are significant. It is unlikely that G&F has the resources to build its brand identity effectively or that this investment would generate a higher rate of return than investment in other strategic initiatives.

Although G&F has made considerable commitment and investment into the new name and branding, it is important that G&F be cautious that it does not continue down the "non-credit union" path simply due to management inertia. While the reference to "financial group" may be more reflective of the comprehensive package of financial services that it offers to members, it does not convey any relationship to banking services. Although several of the Schedule I banks have included the term "financial group" in their names, they have maintained a reference to their original brand identity or have included the term "bank" in their name – BMO Financial Group, RBC Financial Group and TD Bank Financial Group.

G&F should reconsider its decision to drop references to its affiliation with the credit union system. People know what a credit union is and have some security in knowing that a credit union is a legitimate financial institution; an unfamiliar "financial group" does not generate the same level of consumer trust and confidence. Without undertaking another name change, G&F can openly acknowledge its affiliation with the credit union system through use of the credit union logo and by openly acknowledging that it is a credit union. Identifying itself as the tenth largest credit union in B.C. will convey a greater level of credibility than if it were to identify itself as "a member owned financial institution" with twelve branches.

5.2 Strategic Alignment

5.2.1 Develop and Implement a Sales and Service Strategy and Culture

The current activities of G&F indicate a tendency toward a cost-based approach versus a differentiation approach. Although the cost-based approach has been effective in improving operational efficiency, the credit union has been remiss in addressing the revenue side of the operating efficiency equation. That is, increasing the productivity of existing resources by increasing business with existing members and attracting new members. Given the increased level of consumer choice and the reduction in consumer search costs, G&F must ensure that it is able to differentiate itself from the competition. With the commoditization of financial services products, it is imperative that G&F provide comparable, if not better service than its top competitors. To that end, G&F needs to develop a comprehensive sales and service strategy that will support the business strategy.

A key objective to developing and implementing a sales and service strategy is to build the credit union's competency in serving the member. It is important to have friendly and courteous staff; however, as consumers become increasingly more sophisticated about financial services, G&F needs to increase the skill and knowledge of staff so that they are better equipped to proficiently serve members. This will enable G&F to establish its credibility as a financial services advisor. G&F must undertake a rigourous analysis of the skills and knowledge needed by staff to excel in member services, and to determine existing skills and knowledge gaps. In addition, employees must enhance their understanding of the credit union's products and services, know how to identify members' needs, and be able to recommend appropriate products to meet members' needs.

Developing and maintaining a core competency requires ongoing attention and maintenance. Just as standards are set for financial performance and rigourously monitored so

that management may address issues before they become problems, G&F should apply the same level of rigour to developing and ensuring adherence to service standards. Development of comprehensive service standards and staff competencies will facilitate consistency in service across all branches, establish a standard for evaluating staff performance and development needs, and set recruiting standards for each position. In addition to formal training needed to develop the competence, maintenance of the competency requires ongoing coaching and feedback by supervisors and managers. Managers should have the same level of accountability for employee development as they have for managing financial performance.

To be successful, a sales and service strategy must also eliminate obstacles to providing efficient and high quality service. Streamlining of approval processes will enable staff to be more responsive to members; by increasing the overall skill and knowledge of employees, they should be able to handle complex decisions and, therefore, granted greater decision-making authority. G&F should also pursue opportunities to automate labour intensive, mundane activities. Back office support functions and technology should facilitate efficiency and effectiveness in serving members.

HR plays an integral role in supporting a sales and service strategy. In addition to supporting the training and development activities necessary to develop the skills and knowledge of staff and managers, HR is responsible for ensuring that other programs are in place that support and reinforce a sales and service culture. Compensation and reward systems serve to reinforce the achievement of sales and service objectives. Performance management systems and processes ensure that managers are accountable for managing employee performance, and that HR is able to address development challenges and development opportunities. With responsibility for recruiting, HR reinforces the quality standards set for hiring new employees and implements strategies to attract the best and the brightest. In addition, HR ensures that it is able retain its top performers and keep them inspired and motivated. All of these HR activities highlight the strategic role of HR. By understanding the business strategy and the needs of each of the functional areas, HR is able to develop and implement "people" strategies aimed to support the credit union's business goals.

Effective alignment of an HR strategy with G&F's business strategy requires representation of HR at the executive management level. This will ensure that business strategies consider the capabilities and capacity of its employees and the impact on HR issues. More important than having a great business strategy is a firm's ability to execute it effectively.

Execution requires having people with the right skills in the right position. G&F's ability to differentiate itself will be constrained by its under representation of HR at the strategic level.

To support a sales and service strategy, G&F should create a position to implement a training and development program. The role of this position would be to assess current skills and knowledge of employees and identify both the immediate and long-term training and development needs of employees. The training and development expert would then be responsible for ongoing development and delivery of training programs either personally or through contractors. In addition, this position would be responsible for supporting all areas of the organization to ensure that G&F establishes and maintains a highly skilled and knowledgeable workforce that will enable the credit union to establish credibility and differentiate itself from other financial services providers.

5.2.2 Market Development

With an aging membership, G&F must develop ways in which to attract new members. The review of G&F's membership demographics indicates that relative to the population distribution of the GVRD, young adults and females are significantly under-represented among its membership. Although younger people tend to be less loyal, they can be considerably valuable. Younger people tend to have a greater need for financing assistance and, if their loyalty can be won, they offer many years of continued value. Their higher use of technology also means that they cost less to serve than those that rely on in-branch services. Attracting these members could prove to be very profitable.

In order to attract this group, the credit union needs to develop its understanding of what this group wants and how they want it. This is not only important for attracting new members, but to also retain existing members. By developing a better understanding of this group, G&F can more effectively target its marketing, especially if G&F is able to further segment on profitability and lifetime value of the member. Understanding this younger group will be particularly important as G&F expands into communities such as Surrey and Port Coquitlam where the population is comprised of younger adults and families whose needs, attitudes and behaviours differ from older members.

Because younger people are heavier users of electronic banking channels, particularly internet banking, G&F needs to evaluate the effectiveness of its website for marketing G&F. G&F does many things that differentiate it from its competitors; however, it is not terribly effective in communicating these differences, particularly on its website. G&F's website should

clearly promote the advantages and benefits of being a member of G&F versus some other financial institution, without the visitor having to exert a lot of effort. G&F should make it easy for a member, or potential member, to know how G&F stands apart from other financial institutions.

5.2.3 Branding

The goal of most branding exercises is to develop a brand so powerful that customers are loyal to it, and the minimum goal is to achieve brand awareness. Before G&F can develop brand loyalty it must first develop brand awareness. This is a significant issue that G&F must address since the G&F name is a relative unknown. Branding is more than a renaming exercise. In order to build a successful brand, G&F must not only continue to work on developing awareness of its brand, but must also ensure that it has determined what it wants the G&F brand to represent – that is, what is the brand's promise to members. G&F must link this promise to something that it realistically can deliver, to markets that it can serve. Developing a brand that is inconsistent with G&F's strengths and capabilities is likely to result in a negative brand image. For example building a brand based on wealth management services, would not be building on an organizational strength. Again, the earlier recommendation to develop a business strategy should provide valuable guidance in defining the G&F Financial Group brand.

In order to build the G&F brand and awareness of it, G&F ought to ensure that its branding activities become a priority rather than an activity that gets sidelined because of merger related activities. Branding is an activity that G&F must carefully manage so that it can continue to enhance and maintain brand awareness and equity. Lack of steady attention to branding efforts, even for short periods, can result in lost momentum and brand value, especially in the brand awareness stage. In addition to having the resources available to carry out these activities, G&F needs to assess carefully whether it has the level of expertise needed to carry out branding activities. If it does not, G&F should seek the assistance of someone with expertise in this area.

5.2.4 Marketing Focus and Strategic Direction

In general, G&F's marketing activities lack strategic focus and direction, and tend to be tactical in nature. The available skills and resources of each of the two credit unions appear to have driven the marketing activities in the past, versus the marketing strategy driving the activities or marketing mix. This has likely been due to the absence of a marketing plan that supports the business strategy. Once G&F identifies its business strategy, it must develop a marketing plan to guide the allocation of resources and to ensure achievement of marketing

objectives. With the "in-house" approach to marketing, G&F may be limiting the effectiveness of its marketing spending. G&F simply does not have in-house the depth nor breadth of skills needed to market itself effectively. This highlights the need for G&F to undertake an assessment of its current marketing competencies relative to what it needs. For those areas where the credit union does not have strength, these activities should be outsourced. In addition, G&F should assess the value its high volume, low cost marketing activities, versus the value of investing in fewer, moderate to high valued marketing activities.

As discussed earlier, the credit union also needs to attract new members to replace those lost through attrition and to achieve organic growth. In order to cultivate loyal members for the future, G&F needs to begin sowing the seeds today. To ensure that marketing balances the need to grow share of wallet as well as grow the membership, G&F should specifically allocate a portion of its marketing budget to these separate objectives. Marketing activities aimed at membership growth, as well as branding activities, will be important for the new branches.

Word-of-mouth advertising can be one of the most effective means for promoting the credit union's services; it can also be highly effective in destroying it. Word-of-mouth advertising is perceived as credible, and is cheap. However, the credit union must be worthy of talking about and recommending. Although the member referral program can be an effective vehicle for word-of-mouth advertising, the credit union must be offering something of value to members that make members want to recommend the credit union to others. Due to the power of word-of-mouth advertising, G&F must be very conscious of its efforts to ensure that at every touch point with its members it is creating value for the member, and making a positive impression.

To be responsive to member needs, the credit union should undertake regular member research to ensure that it is continuing to exceed member expectations. Research should be designed such that the credit union is better able to understand the needs, attitudes and behaviours of different demographic groups. The closer the research is to an individual, the richer the information (e.g. focus groups versus telephone survey). This will enable G&F to ensure that it designs its products and services to meet the needs of those groups that have greater potential in terms of their lifetime value, versus focussing on the majority of members. Although data mining of membership data indicates how current members use the credit union's services, it does not provide an indication as to what they need or want from their financial institution. Data mining provides simply that, data. Data has its value, but it should be complemented with the

rich information that comes from talking with members in order to understand what they want, and how they want it.

5.2.5 Creating Differentiation

Although a number of high level activities have been identified that would enable the credit union to differentiate itself, there are also a variety of minor activities that would enable G&F to enhance its service level as well as differentiate it from its competitors. For example, G&F's hours of operation are inferior relative to its competitors. At a minimum, G&F should consider extending its hours of operation in order to bring them in line with the market (i.e. Monday openings and longer hours on Saturday) for those branches where the volumes support it. For the new branches, G&F may want to consider whether hours of operation beyond traditional banking hours might make G&F more attractive to new members. For example, closing a half-hour later than competitors may make a difference in its ability to attract new members. G&F may also want to consider the way it delivers service to the member. For example, Lenders could go to members to complete a loan application at a time and place convenient to members.

Post-sales service follow up with members (e.g. a housewarming gift with the signing of a mortgage) reinforces to them that G&F values their business. With so many choices available to consumers, financial institutions are privileged to have a member's business, not the other way around. Mistakes rarely break customer loyalty, but mistakes or problems that are handled poorly will not only turn members away, but also their friends and family that could have been potential members – again, the power of word-of-mouth advertising. Acknowledgement of mistakes or problems with a sincere apology can have a significant impact on members' reactions to a negative event. Of course, that is only if the credit union rectifies problems in a satisfactory and timely manner. This calls for a diligent process of follow up with members who are closing an account or transferring some of their business elsewhere. In addition, G&F should train its employees on problem resolution and give them the authority to resolve problems "on the spot."

With consumers rating service as the most important factor in selecting a financial institution, and financial institutions are failing to meet consumers' expectations, there are considerable opportunities to serve the unfulfilled needs of consumers. It simply requires an effort to understand targeted consumers, and a willingness and flexibility to do things differently. While many of these activities are highly imitable by competitors, a financial institution that develops a competency in understanding its target market's needs, and is committed to

continually responding to these needs, has the opportunity to differentiate itself not just on a variety of small activities, but based on superior responsiveness to the needs of consumers.

5.2.6 Development of Core Competencies

Although G&F has developed considerable strength in many of its support activities, particularly related to planning and financial management, it does not demonstrate a superior level of strength in any of its primary activities – that is, the activities that "touch" the member. The development of core competencies enables organizations to differentiate themselves from their competitors. In order to differentiate itself from its competitors, G&F must carefully consider those areas in which it has the potential to be superior to competitors in a way that provides value to members. It must then focus on building its strength in these areas.

Given the inherently higher cost of delivering services to members via branches, G&F must leverage this high cost delivery model to provide value to members and the credit union. In addition, it is easier to build competence in areas where the credit union exhibits strength. Strong member relationships and rapport can serve as a solid foundation on which to build its core competence in member service. Enhancing the level of knowledge and expertise of employees will enable them to deliver more consistent and accurate advice to members, and do so with greater efficiency. Increasing the level of skills and knowledge of staff is imperative in order for G&F to earn credibility and build its brand. In addition to reviewing staff skills, it must review branch systems and approval processes to identify ways to enhance service efficiency. To stand out, G&F should look at ways in which it can enhance members' experiences when they visit branches.

In order for branch staff to be effective in serving members, administrative office management and staff must also develop their level of expertise and knowledge so that they can provide exceptional support to those that serve members. It is pointless to develop the skills and knowledge of branch staff if they are unable to obtain fast and accurate responses to their questions and requests from head office staff. Further, head office staff, particularly those that are involved with branch operations, need to be creative in how they approach member service in order to identify new and innovative ways to serve and deliver value to members.

Just as it is important to identify and build on a core competence, it is also important to identify those areas in which the credit union does not have a core competence. In those areas that the credit union does not have a core competence, it needs to determine whether it is more efficient and effective to outsource for that competency, or develop the competency in-house.

5.2.7 Future Merger Direction

The merger strategy of G&F's CEO has proven to enhance the strength and performance of the credit unions under his leadership. Despite G&F's straggling performance in recent years, there is no reason to believe that the new G&F will not continue to achieve the same superior levels of financial performance as was achieved by United. Because the mergers have proven to have a positive effect in improving operating efficiency and profitability, it is likely that the CEO and Board of G&F will continue to seek new merger partners.

Rather than focusing on mergers, G&F should lay low for a while so that it can focus on the strategic improvements needed to build a strong, competitive organization. However, a potential risk with slowing down its pursuit of mergers is that it could lose its key merger employees. If the thrill and challenge of mergers inspires and motivates these employees, a slowdown in merger activities could cause these employees to lose interest in their work, resulting in them seeking new challenges elsewhere. Therefore, G&F should leverage strategic initiatives as a means to continue to challenge and develop its key merger employees. In addition, with the continued success of its mergers, G&F's merger competency is likely attracting increased attention from other credit unions. As a result, G&F could be at risk of other credit unions soliciting its key merger employees as other credit unions also pursue mergers as a means to achieve scale efficiency. Therefore, it is important that G&F undertake activities to ensure that it is able to retain the talent that is integral to this competency.

With so few potential merger partners available, G&F must seize merger opportunities when they arise, as increased size has the potential to deliver greater scale efficiency. To the degree that G&F's CEO is actively pursuing other credit unions, it is advisable that G&F tone down the intensity of pursuit for a short period. Continued growth without a solid business strategy and organization structure, is like building on a stressed foundation. At some point, something must give and the damage created may be irreparable.

5.3 Conclusion

The industry analysis highlighted increasing competition for this low growth market, with the greatest challenge being the entry of firms with low cost delivery models. Hence, G&F's continued efforts to improve its operating efficiency will enable it to maintain competitive pricing and margins in this highly competitive industry. The growth through merger strategy employed by the current CEO has clearly lead to increasingly strong financial performance; however, continued improvements in operating efficiency will not be sufficient to

survive into the next decade. To achieve long-term competitive strength, G&F must be able to differentiate itself from competitors. G&F must exercise caution that its focus on mergers and cost management is not crippling the organization in other areas that are fundamental to developing, and executing, a sound business strategy that will enable it to achieve a competitive advantage.

APPENDIX

Peer Group 5 Credit Unions

Coast Capital Savings Credit Union

Envision Financial

Gulf and Fraser Fishermen's Credit Union (G&F Financial Group)

North Shore Credit Union

Prospera Credit Union

Vancouver City Savings Credit Union

Westminster Savings Credit Union

Asset Group 2 Credit Unions

Aldergrove Credit Union

Evergreen Savings Credit Union

Gulf and Fraser Fishermen's Credit Union (G&F Financial Group)

Northern Savings Credit Union

Salmon Arm Savings and Credit Union

Sunshine Coast Credit Union

United Savings Credit Union

Van Tel/Safeway Credit Union

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[32] Credit Union Central of British Columbia, 2003 Products and Services 39-40.

[33] Millward Brown Goldfarb 17.

[34] Millward Brown Goldfarb 17.

[35] Credit Union Central of British Columbia, 2003 Products and Services 41-43.

[36] "Caisse populaires" are the parallel to credit unions and located primarily in Quebec and other Francophone communities in Canada.

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[48] The term "merger" is used loosely as in many of the situations, a larger credit union acquires the assets of the smaller entity and the smaller organization is "absorbed" by the larger credit union.

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