

Outsourced CU

White-Label Services for Credit Unions Using Collaboration

Background

At the rate of nearly one a day, credit unions are falling by the wayside. In this matured industry, most of the consolidation is occurring in the form of mergers, with a small percentage of credit unions going into conservatorship. Fewer than 10 credit unions were started in 2008, a further sign that the industry has reached its declining phase.

In most normal business cycles, a company or industry survives by greatly increasing their economies of scale, thus offsetting the loss of revenue and sales associated with the downturn. Unfortunately for the credit union industry, large gains in economies of scale, measured by a credit union's efficiency ratio, are not realized until a credit union is able to achieve greater than one billion dollars in assets. Once at that magical asset size, a credit union's efficiency will be nearly 40% greater than that of a local competitor half their size.¹

Unlike other industries such as technology or banking, credit unions are not able to fund growth with secondary capital. With this restriction in place, small credit unions or groups of people wishing to start credit unions are at a severe disadvantage as they will most likely never be able to gain the economies of scale needed to succeed in such an industry.

The credit union industry needs a mechanism in place to allow for credit unions of all sizes to achieve the economies of scale normally reserved for the very large credit unions. Credit unions were founded by like-minded individuals who wanted to financially further themselves and their associates. In the past century, having a job at a credit union has dramatically changed. People who started credit unions did not want to be accountants, information technology specialists, or facilities managers, but nearly all credit unions have those positions in their organizational structure or employees who are responsible for them.

Credit unions need to get back to the fundamentals of why they were started and not get mired down in the details of running a very complex business.

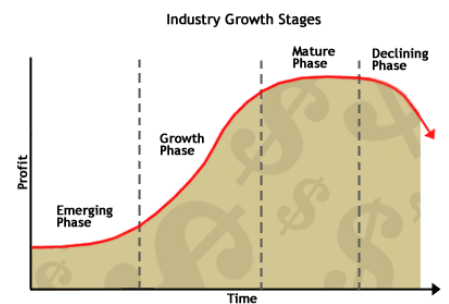


Figure 1 - Investopedia.com

¹ 2nd Quarter 2009 NCUA Call Report

The Idea

Credit unions were never meant to be IT shops, experts in postage and shipping, or specialists in the auditing of financial statements. Over the years, these have become normal operations for credit unions to accomplish in-house and the FTE² count as risen to match these new demands. Credit unions are not the most efficient or cost effective at managing computer networks or facilities. While most CU's have a marketing department of various sizes, chances are there are dozens of companies, both local and national, that can deliver a better product at a cheaper price point. In the footsteps of Plato and Adam Smith, credit unions need to better manage the division of labor and specialization within their organization. All of the back office functions in a credit union, and better than half of their management functions, can and should be outsourced to a provider who is better suited to accomplish a given job.

I propose the creation of a member owned and governed organization whose solitary goal is to enable credit unions to focus on their membership by providing superb operational services.

The Organization

This nation-wide organization will consist of a number of independent companies, each specialized in their own industry, with partial ownership interests held by credit unions and individuals. Each division in this model will hold a number of business units. These individual business units will partner with the best-of-breed providers from around the nation to offer their solution to credit unions. In the Operations vertical for instance, the Information Technology unit will have a variety of partnerships with core processing hosting providers, network services companies, email hosting, and the like. An important distinct in this structure is that these relationships will be with providers of service and not with the manufacturer of the product. In a specific example, the CUSO would partner with OTS (Open Technology Solutions) to provide the OSI system and not with OSI directly. In the same vein, the CUSO may partner with a technology vendor such as OGO (Ongoing Operations) to provide email hosting rather than purchasing a Microsoft Exchange license and running their email system on their own.

Ownership

The top two levels of this CUSO are available for investment. When a credit union wishes to utilize the services of one of the business units, payroll processing for example, that credit union, at a minimum, must invest into the Administration subsidy of the CUSO. (See figure 2) Member shares will be priced in such a many as to allow all credit unions, regardless of size, to invest into the business unit. For each business unit that a credit union utilizes, it must also invest in the business unit's parent organization. For example, a credit union may elect to use the Human Resources, Payroll Processing, and Facilities management functions of the CUSO. In this case, the credit union must invest into both the Administration subsidy as well as the Member Experience subsidy.

Optionally, a credit union may elect to invest into the parent CUSO as well, either at the time of their initial investment or during a stock issuance window. Bylaws for both the CUSO holding company and

² Full Time Equivalent

the subsidy companies will govern the percentage of ownership interest allowed by an individual or an individual credit union to ensure an equitable distribution in the governance structure.

Governance

Each subsidy company will maintain a five member board of directors that is responsible for directing the function of each business unit. The CUSO holding company will have a seven member board of directors as well that oversees the entire operation.

Subsidy board seats will be available on a first come, first serve basis while the initial investment window is open. Once the board of directors has been populated, yearly elections will be held to fill vacant spots. Each board of director's position serves a bi-annual term. The directors will be voted into position by the clients of each respective vertical. The board of directors for the holding company will be structured the same, with the exception of board election. Rather than business unit clients electing their vertical's board of directors, all investors in the subsidy companies and the holding company will each get a vote to determine the board makeup. Exactly like credit unions: one member, one vote.

On occasion, the CUSO holding company will be presented with an opportunity to fill a market niche that has yet to be met by a provider. In these cases, the holding company may gather current clients to invest into a new business, business unit, or vertical. These new organizations, owned entirely by the CUSO holding company and member credit unions, will each have their own board of directors, again with established bylaws identical to the existing subsidy companies.

Operations

The CUSO holding company and its subsidy verticals will act as a consultant, an expense sharing opportunity, and an investment opportunity. To fulfill its mission of enabling credit unions to focus on what they do best, the CUSO holding company will primarily serve credit unions by offering commoditized services that a credit union may be currently doing in house. Alternatively, a prospective group of individuals may approach the CUSO holding company about starting a new credit union. The holding companies goal will be to provide services to run all operational aspects of the credit union, with the exception of management.

For example, a group of Jeff Gordon fans may approach the CUSO holding company about starting a credit union specifically for Jeff Gordon NASCAR fans. While these fans love the idea of having NASCAR branded debit and credit cards, checking accounts that pay out in NASCAR logowear, and contests to ride with Jeff Gordon, they most likely will not know the ins-and-outs of operating a credit union. To help these fans create their own branded credit union, the CUSO holding company will offer their credit union services in a "white-label" fashion. Ultimately, the Jeff Gordon fans do not need to know if PSCU, FSCC, or Fidelity is running their credit cards. They just want it to work. They do not need to know that Digital Insight is running online banking for the credit union instead of Online Resources, PSCU, Jwaala, or another provider.

See also: <http://redneckbank.com>

Another analogous comparison may be made between the CUSO holding company and [Ning](#). Ning has taken a desire that many people have to create a community around a specific niche and made it very simple for them to see their idea come to fruition. Ning has created the framework for an individual to create their own social network on the fly. The CUSO holding company's goal is much the same: offer all of the back-end services necessary to enable new credit unions to be started or existing credit unions to streamline their operations to better serve their members.

In a concept I've coined the "Franchise Mentality", credit unions operate exactly like a franchise of Subway, McDonalds, the Dollar Store, or a Chevron down to the branch level. The CUSO holding company enables the entrepreneurial individuals to start their credit union without having to find suppliers for napkins, plastic bags, roast beef, 89 octane, hamburger buns, or metal shelving. By removing the distractions of the common and commoditized, credit unions will be better able to differentiate themselves in very crowded markets and ultimately revive the industry by introducing new growth using previously under-utilized techniques.

Business Development

In order launch the CUSO holding company, a great deal of networking, marketing, and finagling needs to be accomplished to get the right set of CUSO's, vendors, and credit unions involved. NACUSO, CUES, Filene, CUNA, multi-owned CUSO's, other credit union vendors, and credit unions will be instrumental in developing a network of like-minded companies and credit unions to build an environment such as this.

At first, an informal network of contacts will be made with acquaintances of those involved throughout the industry to sense the interest in the project. Once the concept has been hashed over and reviewed by a number of experienced industry leaders, a more formal marketing campaign will be initiated to educate the industry about the concept behind the CUSO holding company and the goals of the organization. As the education period progresses, many of the necessary relationships and partnerships will be solidified, as well as some of the initial investors.

The Future

Using the "Franchise Mentality" and focusing on what they can do best, credit unions have the opportunity to greatly expand how they interact with the members by eliminating most of the fluff that is normally associated with running a credit union. If the industry can adopt a model such as this, we may see a new wave of credit unions being started and existing ones dramatically improving their efficiency. With the current state of technology, credit unions are no longer bound to geographical limitations. The removal of these barriers opens up new possibilities for serving a niche market with a credit union, whether that market is Jeff Gordon NASCAR fans, Mary Kay consultants, or windsurfers.

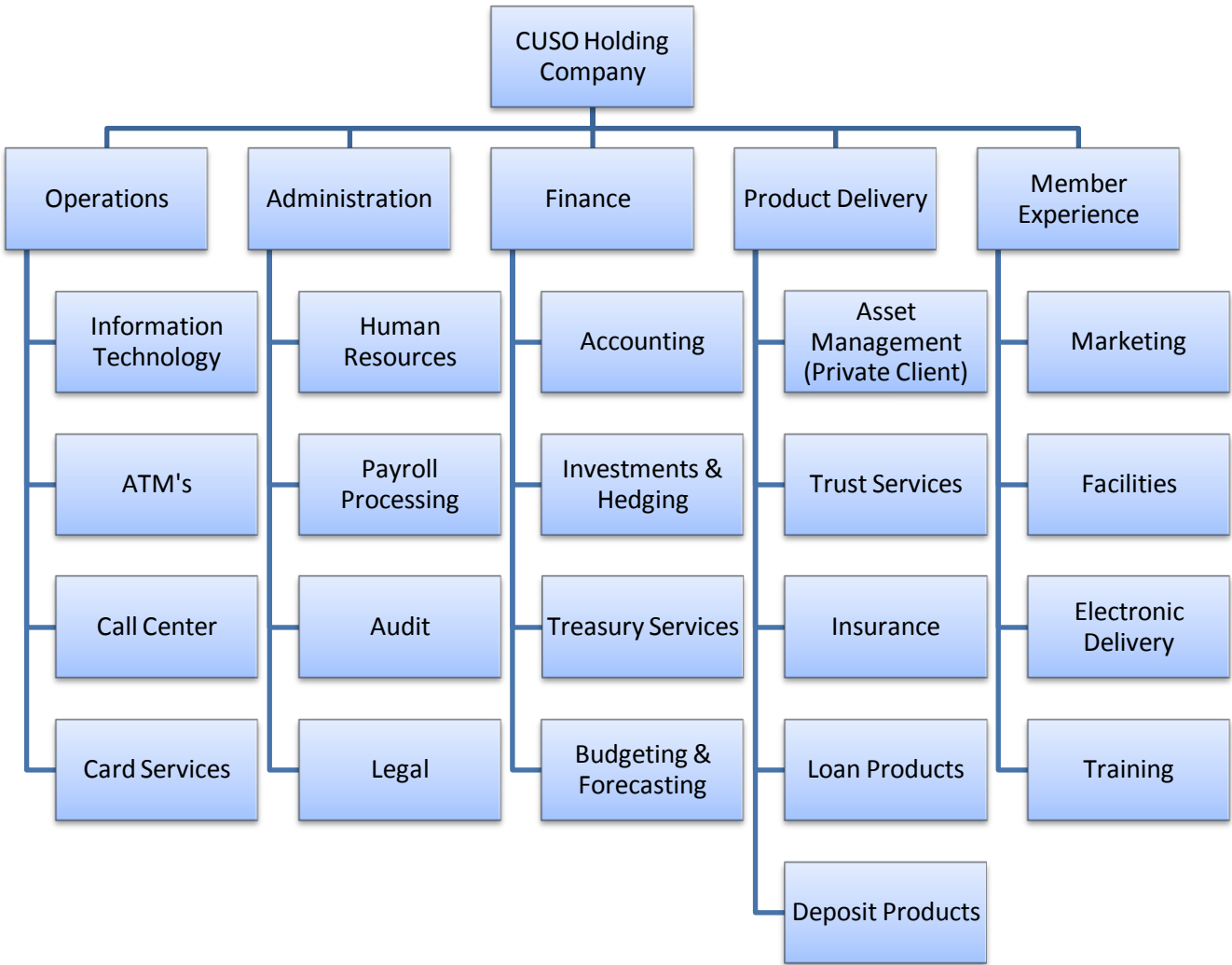


Figure 2 - Proposed Organizational Layout