CANADIAN CENTRE FOR THE STUDY OF CO-OPERATIVES (CCSC)

Mergers are the Best Hope for Canadian Credit Unions Facing Stagnating Growth: Study

Author(s): **Dr. Abdullah Mamun**
Professor, Edwards School of Business
Fellow in Credit Union Finance, Canadian Centre for the Study of Co-operatives

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JOHNSON SHOYAMA
Canadian Centre for the Study of Co-operatives
UREGINA USASK

Why have so many of Canada's credit unions merged in recent years? One new study's answer: mergers are a lifesaver. The study finds that growth is stalling among the country's largest credit unions. Data show mergers kickstart growth, even if benefits take two to three years to materialize. Consolidation makes operations more efficient and puts profitable new services within reach of a larger membership. The study urges regulators to facilitate cross-border mergers and operations. But it also sounds a cautionary note: if mergers are such an appealing option, we could see a future where just a few very large players dominate the sector. This would bring important cultural and economic impacts across Canada and change the flavour of credit unions for members.

Is bigger always better? A new study finds that, when it comes to growth among Canadian credit unions, mergers are becoming a ticket out of increasing stagnation.

The study, by Professor Abdullah Mamun, a Canadian Centre for the Study of Co-operatives research fellow who teaches in the University of Saskatchewan Edwards School of Business, was recently published in the International Review of Economics and Finance. It shows that, in a sample of Canada's 100 largest credit unions, mergers made credit unions more efficient, allowed them to lend more, and facilitated a larger scope of income-generating, fee-based services, all of which led to growth over time.

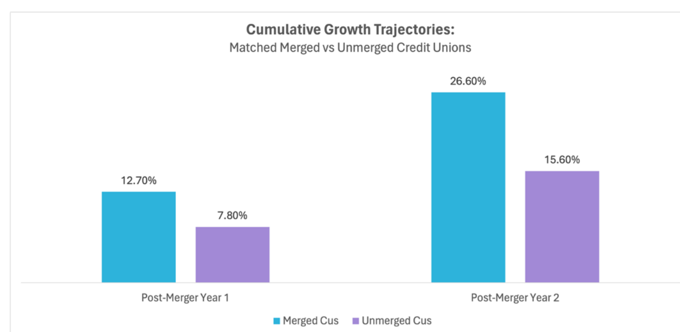
Drawing on data from private sources and regulators' websites, Abdullah's study paints a somewhat worrying picture of Canada's current credit union sector, showing that growth, which was 6.9% between 2007 and 2019 for the sample of credit unions, has been slowing. Abdullah also found diseconomies of scale in the sample, meaning credit union costs increased during the 12-year period under study as efficiency decreased.

Likely, he says, this relates to a regulatory framework in which most credit unions can only operate in limited population centres, usually in a single province. Those narrowly defined markets are hamstringing opportunities for cost savings. For Abdullah, this points to a change in the landscape since the 1980s, when studies found more robust rates of growth in the sector.

The new research helps explain dramatically increasing mergers in Canada in recent years, which has seen the number of credit unions shrink by 50% in the study period. For Abdullah, credit union leaders have clearly read the writing on the wall: without consolidation, costs spiral while income stalls. He finds that, in the period he looked at, many of Canada's credit unions have been overly cautious about lending or simply can't expand loan offerings, ending up with stores of unproductive capital, or what's better known in the financial services sector as a high capital ratio.

This tends to happen when the size of market is limited, Abdullah explains, and it hurts growth.

For now, the study shows, merging with another credit union is often viewed as the best chance credit unions have of kickstarting growth, but benefits take time to show up on the books. Abdullah divided his sample into credit unions that merged with another credit union in a given year and those that didn't. He then matched a credit union that merged, based on pre-merger size and growth, with another non-merging credit union that same year. Next he compared their growth one year and two years after the merger. One year after a merger, credit unions that merged failed to outgrow peers. However, over two calendar years growth in the acquiring credit unions outstripped that of the matched peers. Figure 1 shows the results of the analysis.



In the first full year after the merger took place, the merged credit unions grew a cumulative 12.7% versus 7.8% for the matched credit unions that did not merge. Table 1 further shows that while this represents a difference in growth rates of 4.9 percentage points, statistical analysis reveals that we cannot be sure this difference is statistically significant. It could be that the growth rates are essentially the same. By the second full year after the merger, however, the difference in growth rates widens to a cumulative 11 percentage points and, as seen in Table 1, this difference *is* statistically significant. In other words, we can be confident that this gap is not due to chance.

	Year 1 Growth Rate (Cumulative)	Year 2 Growth Rate (Cumulative)
Merged CUs	12.7%	26.6%
Matched Unmerged CUs	7.8%	15.6%
Difference in growth rates	4.9	11
Probability that difference > 0 (1 tail test)	0.1226	0.019*

For this reason, Abdullah's recommends that regulators should work to make cross-provincial credit union operations easier. This would help credit unions keep their capital ratio at a more efficient level. As for the prospect of national credit unions (three have been approved since federal charters came into being in 2012, and more are in the works), Abdullah argues that federal status can confer a growth advantage if a credit union can afford the time and resources it takes to jump through the necessary regulatory hoops without sacrificing efficiency—an essential component of growth.

For the rest of Canada's credit unions, too small or regional to justify a federal charter, the author recommends that regulators should focus on helping these entities increase the scope of their services as cost-effectively as possible. Abdullah's data shows that noninterest income from a variety of fee-based sources, like insurance offerings and cash management, are a motor for growth. But if smaller credit unions can't afford the price tag to launch new, or expand existing, services, growth will continue to stagnate.

Likewise, referring to previous research about banks, he notes that very small deposit institutions can struggle to innovate technologically, which can limit their ability to offer digital deposit services via websites and apps; mergers can allow credit unions to spread these costs out across a larger membership.

Interestingly, Abdullah's study found no relationship between growth and either the deposit-to-loan ratio or the loan-to-asset ratio. This means growth is untouched by whether credit unions fund loans from their own deposits versus other means, or by holding a higher ratio of loans in their asset portfolio. There was also no relationship between growth and the kinds of loans making up a credit union's portfolio, be they business or consumer loans, or residential or commercial mortgage holdings.

When it comes to credit risk, Abdullah's study found, again, no impact on growth. The author used three common risk measures, including allowances for loan losses, provisions for loan losses, and nonperforming loans. None changed growth. Same for the measure of a "risk-based capital ratio," which is a regulatory determination of how much capital a credit union should have based on its size and risk profile. This measure was not a factor in growth in his sample.

Abdullah's study breaks new ground by pinpointing the exact instruments of growth for credit unions specifically in Canada. He argues that this is needed because previous research from the US and Europe simply doesn't apply to Canadian credit unions due to this country's unique profile. That profile includes a provincially dominated regulatory framework, the "big-five" banking landscape, and credit unions' relatively large reach among Canadians despite their comparatively small numbers vis-à-vis the US and Europe. In fact, with 5.8 million credit union members, plus 4.7 million more served by the Quebec-based Desjardins group, Canada has the highest per capita credit union membership in the world.

Given his study results, Abdullah foresees members belonging to still fewer credit unions in the near future through mergers and more national-level accreditation. Considering that, as of 2019, the top 100 credit unions controlled 93% of the sector's assets outside Quebec, credit unions might soon begin to look more like Canadian banks, whose sector is defined by its handful of players.

For Abdullah, this is reason for concern. Ironically, as credit unions consolidate in the name of survival and growth, they risk losing touch with members. He can foresee a scenario in which Canada ends up with just a few national credit unions and very large provincial ones. This could cause other kinds of problems, for example, in regards to liquidity and rules governing provincial deposit insurance.

Since mergers and federal charters in Canada are likely to continue, Abdullah urges other researchers to continue exploring the effects of economies of scale (meaning increased efficiency) and scope (related to services) on credit union growth across the country.

TAKEAWAYS

- Canada's credit union sector is rapidly consolidating to avoid stagnating growth, suggesting the trend towards mergers will endure;
- Mergers facilitate growth by spreading increasing costs over a larger membership and increasing fee-based income from new services made affordable by bigger membership pools;
- Regulators should consider allowing more cross-provincial credit union operations and facilitating new service offerings;
- More research is needed to fully understand growth in Canada's unique and evolving credit union sector.

You can find the original papers from Dr. Abdullah Mamun's study using the links below:

- Abdullah Mamun, "Understanding Growth and its Policy Implications for Canadian Credit Unions", *International Review of Economics and Finance 86* (2023): 652-665.
- Abdullah Mamun, "Understanding Growth and its Policy Implications for Canadian Credit Unions: working paper", Canadian Centre for the Study of Co-operatives.