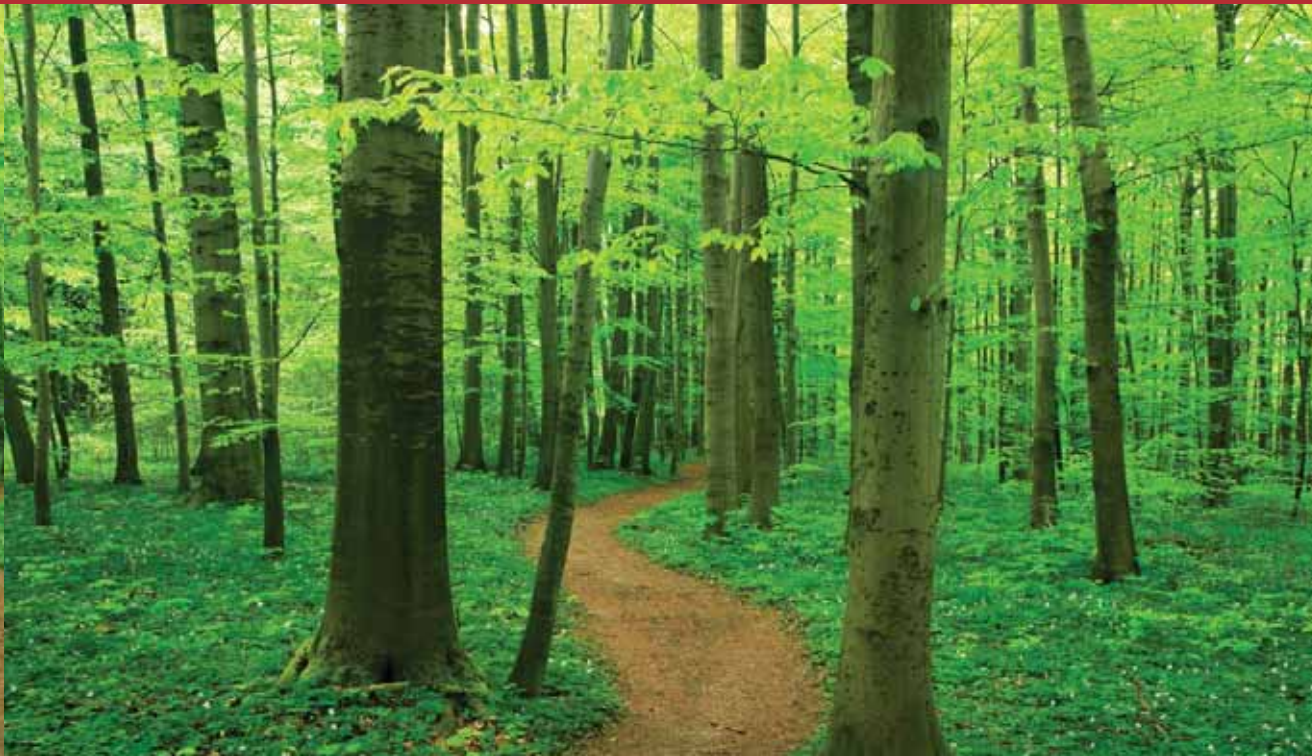


Thriving Large Credit Unions

Robert F. Hoel, PhD

*Professor Emeritus of Business
Colorado State University*

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Deeply embedded in the credit union tradition is an ongoing search for better ways to understand and serve credit union members. Open inquiry, the free flow of ideas, and debate are essential parts of the true democratic process.

The Filene Research Institute is a 501(c)(3) not-for-profit research organization dedicated to scientific and thoughtful analysis about issues affecting the future of consumer finance. Through independent research and innovation programs the Institute examines issues vital to the future of credit unions.



Progress is the constant replacing of the best there is with something still better!

— **Edward A. Filene**

Ideas grow through thoughtful and scientific analysis of top-priority consumer, public policy, and credit union competitive issues. Researchers are given considerable latitude in their exploration and studies of these high-priority issues.

The Institute is governed by an Administrative Board made up of the credit union industry's top leaders. Research topics and priorities are set by the Research Council, a select group of credit union CEOs, and the Filene Research Fellows, a blue ribbon panel of academic experts. Innovation programs are developed in part by Filene i³, an assembly of credit union executives screened for entrepreneurial competencies.

The name of the Institute honors Edward A. Filene, the “father of the U.S. credit union movement.” Filene was an innovative leader who relied on insightful research and analysis when encouraging credit union development.

Since its founding in 1989, the Institute has worked with over one hundred academic institutions and published hundreds of research studies. The entire research library is available online at www.filene.org.

I would like to thank the Credit Union National Association (CUNA) and the National Credit Union Administration (NCUA) for providing much of the underlying data for this study. Also, special appreciation is expressed to the following for their invaluable assistance: Mike R. Schenk, vice president, CUNA Economics and Statistics; Jeanne M. Sheahan, director of research services, CUNA Economics and Statistics; George Hofheimer, chief research officer, Filene Research Institute; Josey Siegenthaler, research associate, Filene Research Institute; and the staff at Kinetic Publishing Services.

	Executive Summary and Commentary	ix
	About the Author	xi
Chapter 1	Research Overview and Key Findings	1
Chapter 2	Performance Measure Findings—All Groups	7
Chapter 3	Why Credit Unions Thrive	13
Chapter 4	Related Research and Discussion	19
	References	23

By George A. Hofheimer,
Chief Research Officer

In business we like to examine outliers. I am willing to wager a sizable sum of money that at the last conference you attended, a speaker alluded to Southwest Airlines, Apple, Google, or Starbucks when illustrating an effective business practice. When referring to these best-in-class performers, consultants are encouraging you to apply proven business practices in hopes that a bit of Google's or Apple's secret sauce will rub off on your credit union. In a similar vein, this study identifies a set of credit union outliers in hopes that you, the reader of this report, will adopt a bit of their traits.

What Did the Researcher Discover?

Using a related methodology to the Filene Research Institute's examinations of small and midsize credit unions (1999 and 2007), this study isolates "star" and "laggard" credit unions in larger asset size groupings and reports their characteristics across a variety of measurements and indicators.¹ Author Bob Hoel, a Filene Fellow and professor emeritus at Colorado State University, reports star credit unions conduct the following business practices and traits, which distinguishes them as exceptional performers over a long time frame:

- They are highly effective lenders.
- Their members use their credit union extensively.
- They excel in high-payoff product and service offerings.
- Their members receive more total interest income on their savings.
- They operate more branches and are more likely to engage in indirect lending.
- They generate more fee income than their peers.
- They invest their capital in growth.

Hoel also reports on the qualities of the low-performing credit unions, or the so-called laggards, which are almost always in sharp contrast to the stars' traits. For example, whereas stars are highly effective lenders, laggards tend to have low loan-share ratios; and while stars invest their capital in growth initiatives, laggards are more conservative with their capital. One of the most exciting findings of this (and previous) research is the consistency of the key success factors for star credit unions across asset size categories and time frames.

Implications for Credit Unions

Despite the uniformity of these success factors, it would be folly for your credit union to read this report and conclude that you need to

1 For an examination of the research methodology, see Chapter 1.

adopt all seven effective practices listed above to become a star credit union. This report makes a variety of assumptions about what constitutes star performance and then teases out the differences between the stars and the laggards. Your credit union may have a different definition of what constitutes high performance by putting less emphasis on asset, earnings, and/or membership growth, for example.²

This is not to say the conclusions of this report are meaningless; in fact, quite the opposite is true. To illustrate my point, let's take the advice of all those consultants and examine Southwest Airlines. In most analyses, the airline industry is an unprofitable business, yet Southwest Airlines has posted a profit for the past 35 consecutive years. Any observer would certainly classify it as a "star" airline. The logical response would be for the many other unprofitable airlines to emulate Southwest, and everything would be hunky-dory. The road, however, is filled with cases of such attempts with less than hunky-dory results.³ The airlines that tried to clone the Southwest magic failed to recognize that the practices they were trying to emulate were a complex set of business processes. To achieve Southwest-like business outcomes, these competitors had to fundamentally change the interaction and alignment of their people, processes, and strategies—something that is much more complex than simply emulating Southwest's notoriously silly preflight announcements, aggressive cost containment strategies, or unique boarding process.

Similarly, it would be folly for your credit union to say, "According to this report, we need to be big fee generators" without understanding the implications of such tactics on your credit union's current personnel, systems, and strategies. Unfortunately there is no such thing as a silver bullet or magic elixir in business performance. In reality, credit union failure or success is dependent on a complex interaction of external and internal factors. This report, and others on the topic of credit union performance, clearly outlines the key factors that lead to credit union success. We therefore recommend using this report as a building block and necessary analysis for your credit union to consider as you ponder future strategies and tactics.

2 For a discussion on this topic, please see Harold M. Sollenberger, *Financially High-Performing Credit Unions* (Madison, WI: Filene Research Institute, 2008).

3 Some of the better-known and ill-fated discount airlines include Song by Delta, Ted by United, the independent start-up Skybus, and Metro-Jet by US Airways.



Robert F. Hoel, PhD

Robert F. Hoel is a Fellow at the Filene Research Institute and professor emeritus of business at Colorado State University. He frequently speaks about credit union challenges and opportunities at meetings of credit union leaders, regulators, auditors, and others. He has spoken at conferences in all 50 states plus Canada, Mexico, Europe, Africa, Asia, Australia, South America, and New Zealand.

Prior to joining Filene, Dr. Hoel was a professor of business and chairman of the Department of Marketing at Colorado State University. He received Colorado State University's "Outstanding Business Professor Award" on three separate occasions. While at Colorado State, he served as chairman of his credit union's board of directors.

Dr. Hoel's primary research interests are in the areas of financial institutions, marketing strategy, and consumer analysis. His research has been reported extensively in academic and industry journals, and he has served as a consultant to a wide range of private-sector and government organizations.

Currently, he serves as a member of the board of directors at Public Service Credit Union in Colorado, the national examining committee for the Certified Credit Union Executive program, the capitalization committee of the National Federation of Community Development Credit Unions, and the credit policies committee at Great Wisconsin Credit Union.

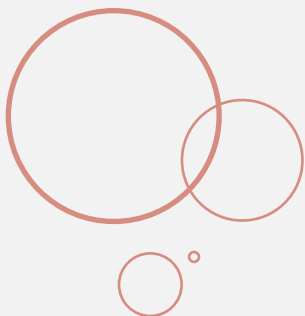
Dr. Hoel is the 2008 recipient of the prestigious Herb Wegner Lifetime Achievement Award for "his body of research in financial institutions, marketing strategy, and consumer analysis and for his many contributions to the success of credit unions." This annual award is made by the National Credit Union Foundation on behalf of the U.S. credit union system.



CHAPTER 1

Research Overview and Key Findings

Why do many large credit unions grow rapidly and thrive while others experience much slower growth in assets, membership, and earnings? Data from a five-year period beginning in January 2002 were analyzed to answer this question.





The Filene Research Institute recently released a report (Hoel 2007) comparing the behaviors of rapidly growing small and midsize credit unions with the behaviors of similarly sized credit unions that were experiencing little growth and sometimes shrinking. The study attracted considerable attention throughout the U.S. credit union system, and Filene received requests for a similar study that would examine fast- and slow-growing large credit unions. This current report responds to those requests.

The general research question is, Why do many large credit unions grow rapidly and thrive while others experience much slower growth in assets, membership, and earnings? Seeking answers to this question, this research examines growth rates, financial data, and product and service information for large credit unions over a five-year period beginning in January 2002.

This research first divides “large” credit unions into four categories on the basis of their assets at the outset of the study period:

- \$100 million (M)–\$250M
- \$250M–\$500M
- \$500M–\$1 billion (B)
- \$1B–\$5B

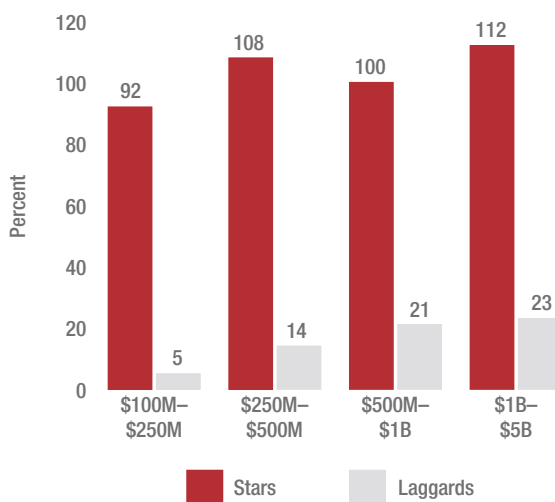
After filtering out extreme cases of asset growth and shrinkage in each group and credit unions that had grown through a merger, the remaining 10% with the greatest asset growth (called “stars” in this report) over the subsequent five-year period and the 10% with the least asset growth (called “laggards”) are identified. Only credit unions operating continuously over the five-year period are included in this study. The net result is 72 stars and 72 laggards.

The asset growth differences between stars and laggards in all four groups are very large over the five-year study period. The average assets of stars in the \$100M–\$250M group grow 20 times more than the assets of laggards do. In the \$1B–\$5B group, stars grow five times more than laggards do.

Figure 1: Average Assets and Five-Year Growth of Stars, Laggards, and All U.S. Credit Unions, January 2002–December 2006 (Millions of Dollars)

	Number of credit unions in group	Beginning average assets	Ending average assets	Growth
\$100M–\$250M				
Stars	42	\$153.5	\$293.9	\$140.4
Laggards	42	\$153.3	\$160.2	\$6.9
\$250M–\$500M				
Stars	18	\$369.9	\$768.7	\$398.8
Laggards	18	\$363.6	\$412.8	\$49.2
\$500M–\$1B				
Stars	8	\$738.8	\$1,477.4	\$738.6
Laggards	8	\$640.5	\$771.6	\$131.1
\$1B–\$5B				
Stars	4	\$2,629.0	\$5,570.5	\$2,941.5
Laggards	4	\$2,406.7	\$2,956.6	\$549.9
All U.S. credit unions	8,535	\$49.9	\$85.1	\$35.2

Figure 2: Five-Year Asset Growth of Stars and Laggards, January 2002–December 2006



Note: Five-year growth in assets for all credit unions is 71%.

Summary Findings: Relative Performance of Stars vs. Laggards

Not only do stars outperform laggards in asset growth, they also outperform using nine other standard performance measures. Their outperformance using these measures occurs in all four asset size groupings over the five-year study period.

Stars, however, arguably underperform laggards in the operating efficiency and capital adequacy areas. It is important to note that net worth levels of both stars and laggards far exceed regulatory definitions of “well capitalized” credit unions. Furthermore, the higher expense ratios of stars are not alarming given their high return on assets.

Why Do Star Credit Unions Perform So Well?

Seven factors contribute greatly to excellent performance of star credit unions:

1. *Stars are highly effective lenders.* Compared to laggards and the national credit union system, stars have loftier loans-to-savings ratios and more loans per member. Their loans are growing faster in almost all categories. Typically, they make larger loans than those made by laggards. The lending success of stars does not appear to be achieved at the expense of asset quality: As a percentage of average loans, their loan delinquencies and net charge-offs are lower than those of laggards and the national credit union average.
2. *Their members use their credit union extensively.* Per thousand members, the numbers of transaction accounts, savings products, and loans are higher at star credit unions than at laggard credit unions. Furthermore, total loans per member in dollar terms is higher at stars, and savings per member is growing faster at stars than at laggards.
3. *They excel in high-payoff product and service offerings.* For example, star credit unions are very successful in growing their used vehicle loans and mortgage portfolios, two product types that create substantial benefits for both members and the credit union. Used vehicle loans have high yields, and mortgage loans tend to be large and create linkages to future member borrowings. Also, a large and growing number of members of stars have

Figure 3: Performance Measures Where Stars Outperform Laggards, All Asset Groups, 2002–2006

Performance area	Performance measure
Assets	Total asset growth Growth in assets per member
Loans	Total loan growth Loans per member Loans/Savings
Membership	Membership growth
Earnings	Net income/Average assets
Asset quality	Delinquent loans/Average loans Net charge-offs/Average loans Bankruptcies per thousand members

Figure 4: Performance Measures Where Laggards Outperform Stars, All Asset Groups, 2002–2006

Performance area	Performance measure
Operating efficiency	Operating expenses/Average assets Employees per million in assets
Capital adequacy	Net worth/Total assets

checking accounts at their credit unions. Checking accounts tied to debit cards are major sources of fee income, and they provide a relationship likely to generate additional loan and savings activity with the member. In the savings area, stars are particularly successful in growing their certificate programs and money market accounts, which tend to attract large deposits.

4. *Their members receive more total interest income on their savings.* Though interest rates on every savings product at star credit unions may not be higher than at laggards, stars usually have savings deposit mixes that result in payment of more total interest to members. Stars' successes with certificate of deposit programs and money market accounts are largely responsible for the high levels of total interest paid to members.
5. *They operate more branches and are more likely to engage in indirect lending.* Star credit unions in all four asset groups operate more branches than laggards. They are more likely to use indirect sources to originate loans in all but the group of largest credit unions, where there is no difference between stars and laggards.
6. *They generate more fee income than their peers.* In all four asset groups, stars generate more fee and other income than laggards.
7. *They invest their capital in growth.* Rather than building excessive capital ratios as laggard credit unions often do, stars invest in expanding their membership, increasing product and service offerings, and growing their asset and loan portfolios. In short, they deliver member value while maintaining adequate net worth levels.

Similarities to Findings in Previous Studies of Small and Midsize Credit Unions

Two previous studies (Hoel 2007; Hoel and Kelly 1999) used general methodologies similar to the one used in the present study, but they focused on small and midsize credit unions. These studies and the present study find that star credit unions outperform laggards on almost all standard performance measures.

In both the 2007 study and the present study, stars outperform laggards using the 10 performance measures listed in Figure 3. When identical performance measures are used in both the present and 1999 studies, the results are much the same. Furthermore, stars in all three studies have lower net worth ratios than laggards. However, while stars in the present and 1999 studies underperform laggards in the areas of operating expenses/average assets and employees per million in assets, stars in the 2007 study outperform laggards along these dimensions.

Implications for Other Credit Unions

One of the most talked about topics in credit union circles in recent years is growth, or, more often, the lack of it. State and national credit union trade organizations have assembled committees and task forces to examine growth issues. There appears to be widespread agreement that credit unions as a whole should grow more in membership and assets in order to accomplish their social and business missions.

This study compares data from 72 fast-growing star credit unions with data from a like number of slow-growing credit unions. Stars and laggards differ greatly. Star credit unions have discovered and implemented ways to attract large quantities of deposits, loans, and members while achieving high levels of safety and soundness. They perform remarkably well according to a wide range of performance measures.

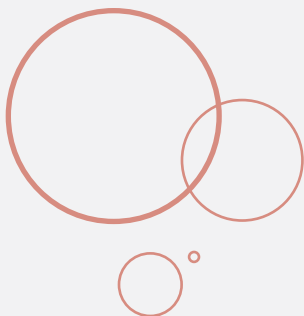
Some credit union leaders may wish to use stars as role models in the highly competitive world of financial services. While every credit union situation is different and not every credit union wishes to grow rapidly, the research results suggest strategies that all credit unions might consider using to improve their own operations and to better serve their members and communities.



CHAPTER 2

Performance Measure Findings—All Groups

Double-digit annual growth, membership growth, higher earnings, and higher average operating expenses are the norm for large star credit unions over the five-year study period. Loan delinquencies, net charge-offs, and bankruptcies per thousand members are lower in star credit unions than in laggard credit unions.





Overall performance findings for star vs. laggard credit unions are impressively similar for all four groups of large credit unions during the five-year study period beginning January 2002. This chapter summarizes these findings. Additional data and discussion for each asset group can be found at www.filene.org/publications/detail/thriving-large-credit-unions.

Asset Growth

Double-digit annual growth is the norm for large star credit unions over the five-year study period, while laggard credit unions typically experience growth in the low single digits or negative annual growth. Growth rates at star credit unions in every size category exceed growth rates for the national credit union system every year during the study. Laggards trail both stars and the national credit union system.

Additional data and discussion for each asset group can be found at www.filene.org/publications/detail/thriving-large-credit-unions.

Figure 5: Annual Growth in Credit Union Assets (%)

	2002	2003	2004	2005	2006
\$100M–\$250M					
Stars	16.8	17.1	11.7	14.2	9.7
Laggards	3.8	3.6	-0.8	-1.3	-0.8
\$250M–\$500M					
Stars	19.8	17.2	14.2	14.2	13.5
Laggards	8.2	3.9	0.8	-2.1	2.3
\$500M–\$1B					
Stars	18.7	15.5	14.0	16.7	9.6
Laggards	9.3	5.4	3.0	-0.7	2.3
\$1B–\$5B					
Stars	21.0	16.5	15.2	13.9	14.5
Laggards	12.8	4.6	2.7	0.2	1.2
All U.S. credit unions					
	11.7	9.5	6.2	4.9	4.6

Figure 6: Five-Year Growth in Average Assets per Member, January 2002–December 2006

	Average assets per member, January 2002	Average assets per member, December 2006	Growth (five-year period)
\$100M–\$250M			
Stars	\$5,353	\$7,717	44%
Laggards	\$6,701	\$7,524	12%
\$250M–\$500M			
Stars	\$7,475	\$10,350	38%
Laggards	\$8,238	\$10,324	25%
\$500M–\$1B			
Stars	\$6,925	\$10,281	48%
Laggards	\$8,970	\$10,136	13%
\$1B–\$5B			
Stars	\$11,058	\$15,934	44%
Laggards	\$15,529	\$17,870	15%
All U.S. credit unions	\$6,313	\$8,310	32%

A key measure of how well a credit union meets its members' savings needs is the assets-per-member ratio. Over the five-year study period, star credit unions in every large credit union category expand their assets per member more than laggards and more than the credit union system as a whole. Deposits-per-member expansion contributes significantly to the total asset growth of stars and the national credit union average.

Figure 7: Five-Year Growth in Credit Union Membership, January 2002–December 2006



Note: Five-year growth in membership for all credit unions is 8%.

Membership Growth

Membership growth in star credit unions far exceeds the national growth rate of the credit union system, while laggards are substantially below national norms. This rapid membership growth in star credit unions is a major contributor to their asset growth.

Lending

Total loans for stars in the four credit union groups grow 97–152% over the five-year study period, while loans for laggards grow only 9–39%. Stars outperform the national credit union system, and laggards underperform the national credit union average.

A key measure of how well a credit union meets members' credit needs is the loans-per-member

ratio. Loans per member increase much more at star credit unions than at laggards and more than the national credit union average over the five-year period.

The loans-to-savings ratio is frequently used to measure a credit union's ability to balance the savings needs with the borrowing needs of its members. A high ratio suggests an ability to pay high interest rates on savings because the yield on loans typically exceeds the yield on investments. Star credit unions in all four groups have higher average loans-to-savings ratios than laggards and the national credit union average.

Operating Efficiency

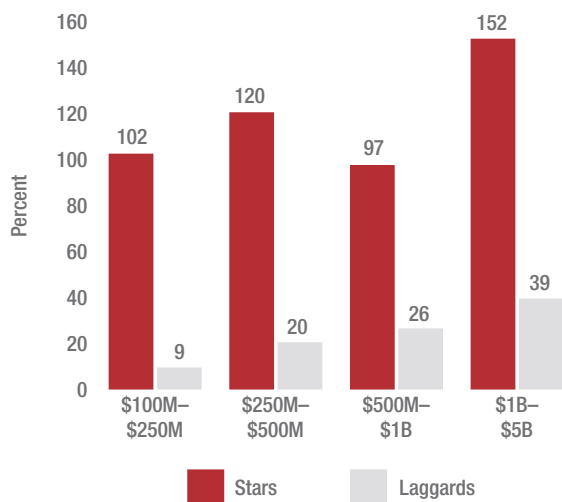
Star credit unions have higher average operating expenses, expressed in basis points (bps) of average assets, than laggards in three of the four asset groups. However, their operating expenses are lower than the national credit union average in three of the four asset size groups.

Star credit unions have more employees per million dollars of assets than laggards in all four categories, but in three groups they have fewer employees per million in assets than national norms.

Figure 9: Five-Year Growth in Loans per Member, January 2002–December 2006

	Loans per member, January 2002	Loans per member, December 2006	Growth (five-year period)
\$100M–\$250M			
Stars	\$3,794	\$5,765	52%
Laggards	\$4,054	\$4,748	17%
\$250M–\$500M			
Stars	\$5,293	\$7,742	46%
Laggards	\$5,083	\$6,711	32%
\$500M–\$1B			
Stars	\$5,201	\$7,608	46%
Laggards	\$5,023	\$5,940	18%
\$1B–\$5B			
Stars	\$7,387	\$12,668	72%
Laggards	\$7,299	\$9,507	30%
All U.S. credit unions	\$4,059	\$5,800	43%

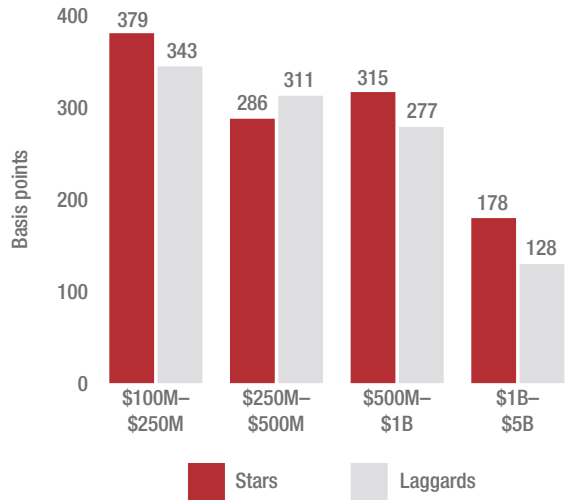
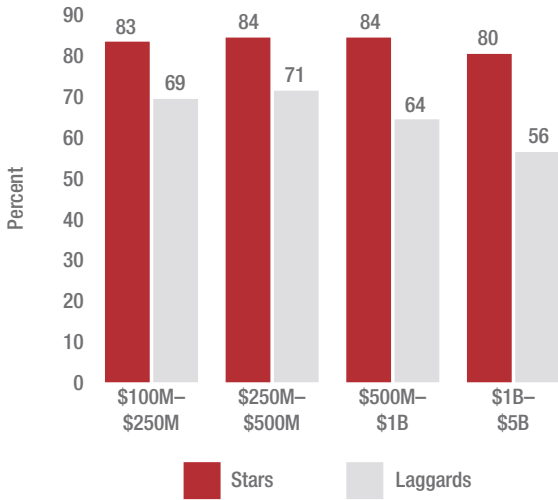
Figure 8: Five-Year Loan Growth, January 2002–December 2006



Note: Five-year loan growth for all credit unions is 55%.

Figure 10: Loans-to-Savings Ratios (Five-Year Annual Averages)

Figure 11: Operating Expenses in bps of Average Assets (Five-Year Annual Averages)



Note: Five-year annual average for all credit unions is 75%.

Note: Five-year annual average for all credit unions is 324 bps.

Asset Quality

Loan delinquencies, net charge-offs, and bankruptcies per thousand members are lower in star credit unions than in laggard credit unions. The same is true when comparing loan delinquencies and net charge-offs of star credit unions to national norms. However, the findings are mixed when comparing bankruptcies per thousand members at stars to national norms.

Earnings

Net income as a percent of total assets is dramatically higher at star credit unions than at laggard credit unions. Stars also have a much higher net income ratio than the national credit union average.

Figure 12: Number of Employees per Million in Assets (Five-Year Annual Averages)

Figure 13: Delinquency as a Percentage of Average Loans (Five-Year Annual Averages)

	Stars	Laggards
\$100M-\$250M	0.42	0.38
\$250M-\$500M	0.26	0.28
\$500M-\$1B	0.30	0.25
\$1B-\$5B	0.16	0.10

Note: Five-year annual average for all U.S. credit unions is 0.34 employees.

	Stars	Laggards
\$100M-\$250M	0.69	1.17
\$250M-\$500M	0.44	0.78
\$500M-\$1B	0.45	0.89
\$1B-\$5B	0.22	0.45

Note: Five-year annual average for all U.S. credit unions is 0.74%.

Capital Adequacy

Laggard credit unions experience *higher* capital ratios than star credit unions do over the study period. Because these laggard credit unions are growing assets slowly but have reasonably good earnings, their net worth ratios tend to drift upward.

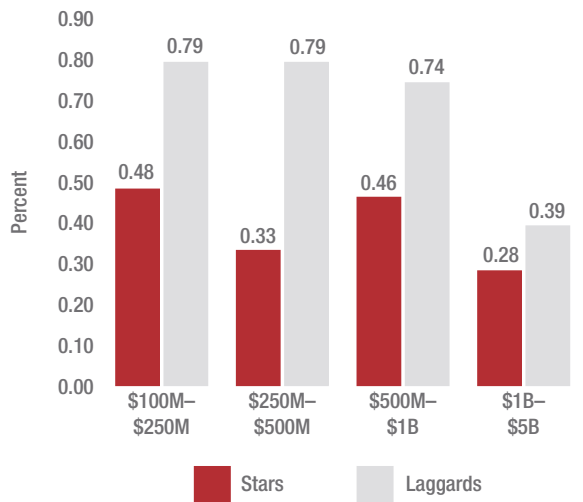
Stars, in turn, have excellent earnings, but their earnings fail to keep pace with their stellar asset growth rates. The result is a tendency for their net worth ratios to drift downward. However, stars maintain high net worth levels relative to the 7% federal government standard used to define “well capitalized” credit unions and the 6% used to define “adequately capitalized.”

Figure 15: Bankruptcies per Thousand Members (Five-Year Annual Averages)

	Stars	Laggards
\$100M–\$250M	3.03	3.23
\$250M–\$500M	2.52	3.38
\$500M–\$1B	3.11	3.19
\$1B–\$5B	2.43	3.36

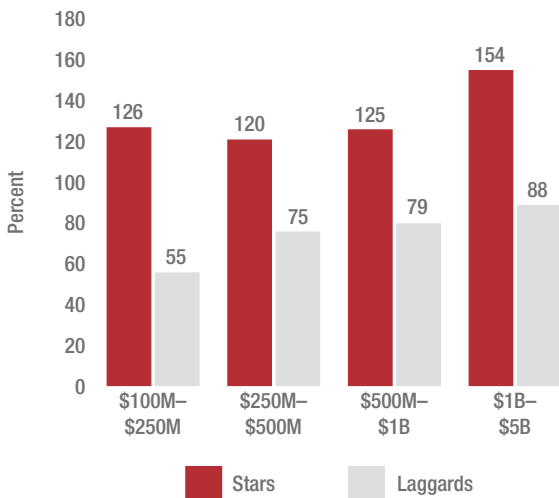
Note: Five-year annual average for all credit unions is 2.91 bankruptcies.

Figure 14: Net Charge-Offs as a Percentage of Average Loans (Five-Year Annual Averages)



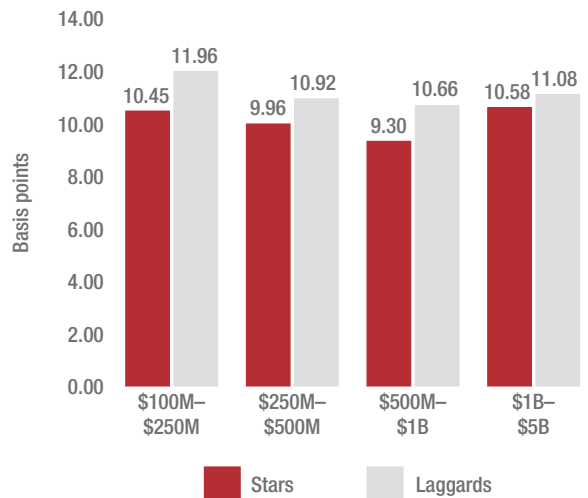
Note: Five-year annual average for all credit unions is 0.52%.

Figure 16: Net Income in bps of Average Assets (Five-Year Annual Averages)



Note: Five-year annual average for all credit unions is 93 bps.

Figure 17: Net Worth Ratios (Five-Year Annual Averages)



Note: Five-year annual average for all credit unions is 11.04%.



CHAPTER 3

Why Credit Unions Thrive

Why do credit unions thrive? Factors that contribute to the success of high-performing credit unions include the following: They are highly effective lenders, their members use their credit union extensively, they excel in high-payoff product and service offerings, their members receive more total interest income, and they operate more branches and generate more fee income than their peers.





Spread Analysis

The left column in Figure 18 shows the basic spread analysis formula for calculating net income.

Star credit unions achieve:

- *Much higher yields on total assets* largely because they are more successful lenders than laggards. They have high loans-to-assets ratios and larger proportions of their loan portfolios in high-yield loan categories like used auto loans.
- *Higher costs of assets* because they are more aggressive in offering certificates of deposit and other products that are more expensive and rate-sensitive than regular share accounts. They typically price deposit products higher than laggard credit unions do.
- *Usually higher gross spreads* because of high yields on assets in relation to the costs of those assets.
- *Higher fee income and other income* because their members are more likely to use checking accounts and other fee-generating products. For all credit unions, including stars and laggards, fee income has become a larger component of total income than in the past.
- *Usually somewhat higher operating expenses* largely because their members use their products and services more frequently than at laggard credit unions.
- *Higher net spreads* because of high yields on assets and relatively high fee income.
- *Lower loan losses* because of the high quality of loans originated and superior collection procedures.
- *Much higher net income* in all three groups.

Additional data and discussion for each asset group can be found at www.fileone.org/publications/detail/thriving-large-credit-unions.

Figure 18: Comparative Spread Analysis (bps of Average Annual Assets), Five-Year Period

	\$100M–\$250M		\$250M–\$500M		\$500M–\$1B		\$1B–\$5B		Stars compared to laggards
	Stars	Laggards	Stars	Laggards	Stars	Laggards	Stars	Laggards	
Yield on total assets	552	510	528	513	520	481	517	435	Much higher
– Cost of total assets	185	170	217	185	205	179	242	251	Usually higher
= Gross spread	367	340	312	329	315	302	274	184	Usually higher
+ Fees and other income	176	102	119	105	160	93	77	51	Much higher
– Operating expense	379	343	286	311	315	277	178	128	Usually higher
= Net spread	164	100	144	123	160	118	173	108	Much higher
– Loss provisions	37	45	24	47	35	39	19	20	Lower
= Net income	126	55	120	75	125	79	154	88	Much higher

Underlying Success Factors

Seven factors contribute greatly to the excellent overall performance of star credit unions. The figures in this section summarize data relating to these factors. More complete data for each asset size group can be found in the appendices to this report, online at www.fileone.org/publications/detail/thriving-large-credit-unions.

In this chapter, spread analysis is used to compare the business strategies of stars and laggards. Also, data that support explanations for high performance are summarized.

1. *Stars are highly effective lenders.* Aggressive lending is central to the overall superior performance of star credit unions. Stars generate more and larger loans than laggards, and their loan portfolios are growing at faster rates. Stars, however, are also effective risk managers with low delinquency and charge-off rates.

Figure 19: Lending Activities—Stars Compared to Laggards (Averages over Five-Year Study Period)

	\$100M–\$250M	\$250M–\$500M	\$500M–\$1B	\$1B–\$5B	Overall
Loans-to-savings ratio	Higher	Higher	Higher	Higher	Higher
Loans per member—\$ value	Higher	Higher	Higher	Higher	Higher
Number of loans per 1,000 members*	Higher	Higher	Higher	Higher	Higher
Average loan size*	Higher	Higher	Higher	Higher	Higher
Total loan growth	Higher	Higher	Higher	Higher	Higher
Vehicle loan growth	Higher	Higher	Higher	Higher	Higher
Total mortgage loan growth	Higher	Higher	Higher	Higher	Higher
Delinquent loans/Average loans	Lower	Lower	Lower	Lower	Lower
Net charge-offs/Average loans	Lower	Lower	Lower	Lower	Lower

*End of study period.

2. *Members of star credit unions use their credit union extensively.*

Star members have more transaction accounts, savings accounts, and loans at their credit union than members of laggard credit unions do. The average loan sizes at star credit unions are higher than at laggard credit unions. In addition, star credit unions are growing their deposits per member at faster rates than laggards.

Figure 20: Product Usage—Stars Compared to Laggards (End of Study Period)

	\$100M–\$250M	\$250M–\$500M	\$500M–\$1B	\$1B–\$5B	Overall
Total savings and transaction accounts per 1,000 members	Higher	Lower	Higher	Higher	Mostly higher
Checking/Share draft accounts per 1,000 members	Higher	Higher	Higher	Lower	Mostly higher
Certificates of deposit per 1,000 members	Higher	Higher	Higher	Higher	Higher
Assets per member growth*	Higher	Higher	Higher	Higher	Higher
Loans per 1,000 members	Higher	Higher	Higher	Higher	Higher
Average loan size	Higher	Higher	Higher	Higher	Higher

*Average over five-year study period.

3. *Stars excel in high-payoff product and service offerings.* High-payoff

loan offerings include used vehicle loans because of their high yields and mortgages and because of their size and linkages to future borrowings. Checking accounts tied to fee-generating debit cards are generally regarded as the highest payoff transaction products. Certificates are also high payoff because they tend to be price elastic and capable of attracting larger deposits. Star credit unions excel in all of these product areas.

Figure 21: High-Payoff Offerings—Stars Compared to Laggards (End of Study Period)

	\$100M–\$250M	\$250M–\$500M	\$500M–\$1B	\$1B–\$5B	Overall
Used vehicle loans per 1,000 members	Higher	Higher	Higher	Lower	Mostly higher
Annual growth in used vehicle loans*	Higher	Higher	Higher	Higher	Higher
First mortgages per 1,000 members	Higher	Higher	Higher	Higher	Higher
Second mortgages and home equity loans per 1,000 members	Higher	Higher	Higher	Higher	Higher
Checking/Share draft accounts per 1,000 members	Higher	Higher	Higher	Lower	Mostly higher
Certificates of deposit per 1,000 members	Higher	Higher	Higher	Higher	Higher

*Average over five-year study period.

4. *Their members receive more total interest income on their savings.* Stars do not pay higher rates on all savings products, but their mix of savings products typically results in members receiving more total interest than laggard credit union members receive. Star credit unions have more and larger certificates of deposit and money market accounts than laggards.

Figure 22: Interest Paid to Members—Stars Compared to Laggards (End of Study Period)

	\$100M–\$250M	\$250M–\$500M	\$500M–\$1B	\$1B–\$5B	Overall
Interest paid to members*	Higher	Higher	Higher	Lower	Mostly higher
Certificates of deposit per 1,000 members	Higher	Higher	Higher	Higher	Higher
Average size of certificate accounts	Higher	Higher	Lower	Higher	Mostly higher
Money market accounts per 1,000 members	Higher	Higher	Higher	Lower	Mostly higher
Average size of money market accounts	Higher	Higher	Lower	Higher	Mostly higher

*Average over five-year study period.

5. *They operate more branches and are more likely to engage in indirect lending.* These activities provide members easy access to star credit unions’ products and services. However, the data are mixed on participation in shared branching with other credit unions.

Figure 23: Branches and Indirect Lending—Stars Compared to Laggards (End of Study Period)

	\$100M–\$250M	\$250M–\$500M	\$500M–\$1B	\$1B–\$5B	Overall
Average number of branches	Higher	Higher	Higher	Higher	Higher
Engaged in indirect lending	Higher	Higher	Higher	Equal	Mostly higher
With shared branch	Higher	Lower	Higher	Lower	Mixed

6. *They generate more fee income than their peers.* In all four asset groups, stars generate more fee and other income than laggards.

Figure 24: Fee Income—Stars Compared to Laggards (End of Study Period)

	\$100M–\$250M	\$250M–\$500M	\$500M–\$1B	\$1B–\$5B	Overall
Total fee and other income	Higher	Higher	Higher	Higher	Higher

7. *They invest their capital in growth.* Rather than building excessive capital ratios as laggard credit unions often do, stars invest in expanding their membership, increasing product and service offerings, and growing their asset and loan portfolios. Though stars have somewhat lower net worth ratios than laggards, they remain well capitalized by government standards.

Figure 25: Capital—Stars Compared to Laggards (Average over Five-Year Study Period)

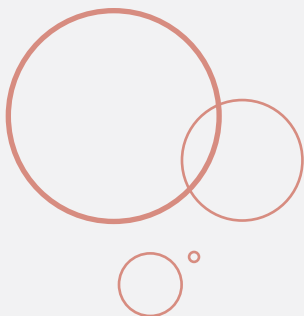
	\$100M–\$250M	\$250M–\$500M	\$500M–\$1B	\$1B–\$5B	Overall
Net worth ratio	Lower	Lower	Lower	Lower	Lower



CHAPTER 4

Related Research and Discussion

Previous studies on star credit unions vs. laggard credit unions have reinforced the following findings: Lending is the proverbial golden goose for credit unions, fee income is of growing importance to most credit unions, and star credit unions deliver great value to members while maintaining adequate capital levels and effectively managing risk.





The findings in the present study are remarkably similar to findings in two previous credit union studies (Hoel 2007; Hoel and Kelly 1999) using the same general methodology of comparing stars and laggards in asset size groups. In all three studies, compared to slow-growing credit unions, high-growth credit unions:

- Are highly effective lenders with large, fast-growing loan portfolios and low delinquencies and charge-offs.
- Persuade their members to use their credit union extensively. Their members are likely to use more products and services, including transaction, savings, and loan offerings.
- Excel in high-payoff products and services that benefit members and the credit union. Examples include used vehicle loans, second mortgages, home equity lines of credit, certificates of deposit, and money market accounts.
- Generate higher yields on total assets and greater fee income.
- Pay more total interest to their members.
- Invest their capital in growth. Though their net worth ratios are lower than those of laggards, they are well capitalized by government standards for credit unions.

The Hoel-Kelly 1999 Study

The first credit union study using the star-laggard methodology examined small credit unions that had \$5M–\$10M in assets at the beginning of 1995. It compared 400 high-growth credit unions and 400 low-growth credit unions over a two-year period. The results are very similar to those of the present study. One additional finding is a broader product menu at high-growth credit unions compared to slow-growing credit unions. Because of scale limitations of small credit unions, the number of products offered is a more significant issue than it is in large credit unions like the ones examined in the present study.

The Hoel 2007 Study

The second study examined three groups of small and midsize credit unions with initial assets of \$10M–\$35M, \$35M–\$50M,

and \$50M–\$100M over a five-year period beginning January 2001. It compared the performance and behaviors of 339 stars and 339 laggards. In the 2007 study, stars outperform laggards in 12 of 13 standard performance measures. As in the other two studies, stars have lower, but more-than-adequate, net worth ratios than laggards.

There were major differences in the operating efficiency area. Stars in the 2007 study clearly outperform laggards in the areas of (1) operating expenses/average assets and (2) employees per million in assets, but stars in the 1999 and present studies clearly underperform laggards along these dimensions. Possible explanations for the differences in results include (1) the large number of loans and other relationships generated by large star credit unions in the 1999 and present studies, and (2) physical and staff development costs associated with rapid growth. Illustrating the first possible explanation is data in the present study showing that stars experience higher loan-servicing costs than laggards do.

Another possible reason for expense differences among the studies is variations in assets per member. Comparing stars and laggards in the present study shows that stars have fewer assets per member during parts of the study period in all four asset size categories. Such strong assets-per-member discrepancies did not exist in the 2007 study. In the present study, average assets per member rise rapidly for stars over the study period, and operating expenses for stars tend to fall. Using a sophisticated regression technique, Doyle and Kelly (2005) found that assets per member is the most powerful predictor of a credit union's expense ratio. Assets per member and expense ratios are inversely related. Therefore, it appears plausible that variations in assets per member in the three star vs. laggard studies partially explain differences in operating expense and employee usage patterns.

Lending—The Golden Goose

All three studies reinforce the notion that lending is the proverbial golden goose for credit unions. The golden goose is the great generator of revenue that enables credit unions to grow and excel. A million dollars of loans almost always generates more gross and net income than a million dollars of investments. Strong lending practices and reputations attract new members and provide sufficient funding for payment of handsome interest rates on savings products and for delivery of high levels of member service.

In their landmark research on lending, Burger and Kelly (1993) document the vital role of lending in credit union performance. They also underscore the importance of management's and the board of directors' commitment to lending as the credit union's number-one priority. As reaffirmed in the present study, effective lending is central

to success. Favorable loan pricing alone, argue Burger and Kelly, is not sufficient to build strong loan portfolios. A driving, relentless “lending attitude” is required.

Though lending is central to success, unfettered pursuit of loan opportunities can produce safety and soundness problems that will become evident in the future. Data examined in this research indicate few delinquency and charge-off problems during the study period, but there is always the possibility that aggressive lending can create loan quality problems later in the event of an economic downturn or if there is a major drop in values in large classifications of collateral. Current national economic problems and changes in the valuations of homes and SUV vehicles are examples of potential problems for some aggressive lenders.

Fee Income—Another Golden Goose?

All three studies also show the growing importance of fee income to credit unions. In many cases, credit unions would have negative net income if they had no fee income. Stars tend to generate substantially more fee income than laggards.

In addition to the benefits of fee income, there are dangers associated with heavy pursuit of it. Members, of course, may move their business to other institutions if fees become pervasive or burdensome. Credit unions can also tarnish their now favorable images if fees become excessive. Furthermore, there is the threat of possible legislative actions that may restrict interchange income and fee levels for financial institutions.

Stars Show Ways to Success

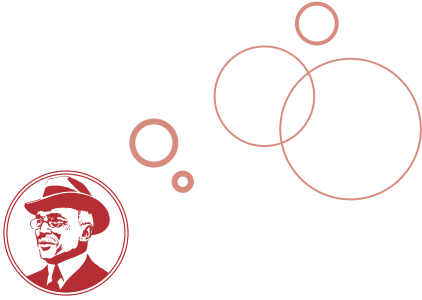
Stars impressively deliver great value to members while maintaining adequate capital levels and effectively managing risk. They are growing and thriving during a period when overall credit union system growth has been modest. They outperform laggard credit unions along a wide range of performance measures. Other credit unions can learn from their successes.

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