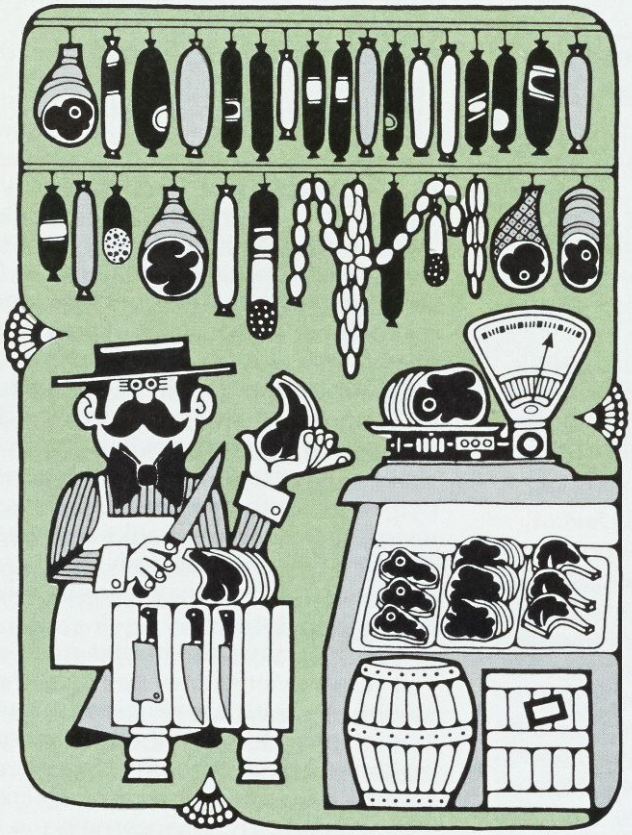
Southeastern Credit Unions: From Delicatessen To Supermarket?



Many larger credit unions are moving toward a more complete line of consumer services. The decision to move from "delicatessen" to "supermarket" is a difficult one, and CUs will face some large and unfamiliar competitors.

Credit unions occupy a distinctive niche in the array of retail financial institutions. Organized to serve members who share a "common bond," such as schoolteachers or employees of a particular corporation, credit unions have come to be regarded by their members as:

(1) friendly and personal, often administered by fellow employees;
(2) a convenient place to deposit savings at a reasonable rate of return, usually by direct deduction from pay checks; and
(3) a source of consumer loans at inexpensive interest rates.[1]

The distinctive niche has its drawbacks, however. Most credit union members, even as they praise the special advantages of CUs, do **not** regard them as "primary financial institutions." In the minds of most customers, credit unions are a **supplementary** source of financial services. In a 1982 survey of members by the Credit Union National Association (CUNA), fewer than three out of ten members described their credit unions as their "primary financial institution," while six out of ten named their banks. So, in general, credit unions have become something like a financial delicatessen—used and admired by a loyal body of customers who nevertheless turn to a supermarket for the bulk of their grocery needs.

Many managers and board members of established credit unions are dissatisfied with this

[1]These are major findings of the 1982 and 1977 "National Member Surveys" conducted by the Credit Union National Association Madison, Wisconsin.

Question: Who will be your most significant competitors between now and 1990?

	Most Significant	Second Most Significant	Third Most Significant
Banks	20	2	0
S&Ls	0	11	2
Money Market Funds	2	5	6
Retailers	1	2	5
Other Credit Unions	0	2	4
Finance Companies	0	0	2
Not Sure	0	1	4

situation. They are increasingly weighing the merits—and the risks—of transforming their "delicatessens" into financial supermarkets, competing head-to-head with commercial banks and other providers by offering a broader selection of financial services. In doing so, they hope to become the "primary financial institution" for the remaining seven-tenths of their members.

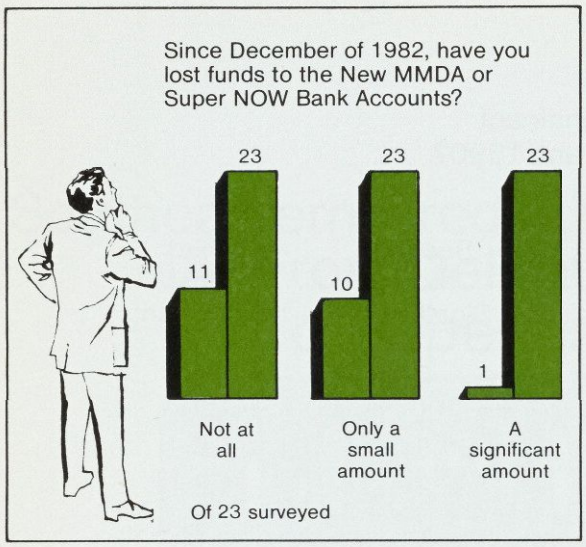
There are several particular reasons why many credit unions are showing "supermarket fever" today. Many managers of larger CUs feel they are close to saturation in terms of marketing traditional credit union services to a limited customer base, and therefore view expansion in the breadth of services as the only realistic way to continue growing. Most larger CUs have begun to offer share-draft (checking) accounts, since this became permissible in the Southeast in early 1981, and success with these accounts has whetted their appetites for additional services. Also, today's credit union manager increasingly is experienced and professional, tending to view expansion as the key to more responsibility and recognition of his or her job. Credit unions have seen their members tantalized by a growing array of financial services, such as credit cards and automatic teller machines, from a variety of new competitors including money market mutual funds and savings and loan associations. Many credit union managers feel, increasingly, that they must "run faster just to stay in the same position." Finally, some credit union leaders are worried that they will lose the unique tax advantages they have enjoyed since the 1930s and are concerned with maintaining profits and markets if that happens.

"The distinctive niche [of credit unions] has its drawbacks, however."

The key question facing larger credit unions today, then, can be put in terms of a pair of alternatives:

—Should a credit union move toward a full-service orientation and become a supermarket or

—Should the credit union remain specialized, even if that means refraining from offering certain services and staying in the delicatessen business?



Survey of Larger Southeastern Credit Unions

We asked this question and others of the managers of 23 large credit unions in Georgia and Alabama in March. The occasion was a conference of these credit unions, "Directions '83," arranged by the credit union centrals of the two states. The credit unions represented were relatively typical of larger associations, except that they probably are more concerned about the future and their role in the future than their counterparts who were not present.

Two-thirds of these institutions said they are "willing to give up some of the traditional contact, if necessary, to move toward full-service orientation." One-third wanted to stay in the "delicatessen" niche.

Opinions were fairly strong on this subject. One credit union said, for example, that the best tactical move a credit union could make right now would be "to find out what services your members really want and provide them." The worst move a credit union could make, according to the same manager, would be to "act like a turtle and pull into a shell, ignoring all the change taking place." This kind of opinion characterized three-quarters of the institutions we questioned. Still, there were dissenters. One credit union said "the worst thing we could do is to jump into many new available services without proper personnel, resources, and research."

Perspective on the Credit Unions

The credit union movement offers one of the most fascinating chapters in U. S. financial history. Credit unions were promoted in the 1920s and 1930s by Edward Filene, a Boston department store magnate, as a means of offering an institutional borrowing and saving capability to blue collar workers in whom the banks showed little interest. Filene had borrowed the idea from Canada, and it also had antecedents in nineteenth century Europe. One of the key concepts associated with the credit union movement has been the "common bond" of employees either working in a particular trade or for a particular employer.

The credit union movement gained substantial impetus with the passage of the Federal Credit Union Act in 1934. As part of the New Deal banking legislation, this act made it possible for credit unions to obtain federal charters and sanctioned the substantial growth of smaller credit unions in the 1940s and 1950s. By the early 1970s, the credit union movement had achieved substantial maturity. By then there were over 20,000 credit unions and their deposits had been insured by a federal insurance program. The composition of depositors was becoming much more white collar in character, concentrated in government and the armed services, and credit union managers were becoming more and more professional.

The next big movement came in the late 1970s, when northeastern credit unions joined other thrift institutions in pushing for the negotiable order of withdrawal account, which was called the share-draft account in the case of credit unions. Under the Monetary Control Act of 1980, credit unions were allowed to offer these interest-bearing checking accounts nationwide at the beginning of 1981. In return, the larger credit unions—those with deposits over $5 million—were required to hold reserves with the Federal Reserve System.

So share drafts essentially represented the first step by many of the larger institutions, who were frustrated at being a secondary financial institution for their customers, toward a full-service financial institution situation. There remained, however, the associations' "common bond" with particular employee groups or employers. This is very important to most credit unions. It makes direct deposit of pay checks into the accounts relatively easy, it often provides for payroll deduction of loan payments, and it offers the credit union publicity within the employee group or work place. It also offers an implicit screening of loan applications, since the employees generally know each other well—and possibly even provides a certain amount of leverage on the employee to be punctual with loan repayments. What's more, it offers a certain image of a cooperative, depositor-oriented institution rather than a profit-motivated bank. In some cases, the employee group or employer has provided volunteer assistance and office space and has even allowed credit unions to use available computer facilities. These employee and employer credit unions comprise by far the majority of the credit unions in the 1980s. Community charters for neighborhood credit unions have not yet become quantitatively important.

Question: Which financial services do you offer or are you seriously considering?

	Now Offer	Seriously Interested	Not Seriously Considering
Share Drafts	23	0	0
Mortgage Loans	13	5	5
Preauthorized Transfers	13	5	5
Credit Cards	4	9	10
ATMs	6	5	12
Debit Cards	2	8	12
Telephone Bill Payments	1	16	6

Interestingly, every one of the 23 credit unions we surveyed said banks will be their primary competitors (20), or their second most important competitors (3), between now and 1990. In contrast, none of the institutions felt other credit unions would be their primary competitors in the late 1980s. This reflects the "common bond" limitation and a lack of overlap among each credit union's members. S&Ls ranked far behind the dominant position of the banks in response to this question. Only a small number of the respondents saw S&Ls, retailers and money market funds as potential competitors in the 1980s.

"Only one-third wanted to stay in the 'delicatessen' niche."

Even so, the credit union managers feel they are doing well against these competitors. Every institution surveyed already offered share-draft accounts, in competition with bank checking accounts. When we asked the extent to which they had lost funds to the new money market deposit accounts or Super NOWs in early 1983, 11 of the institutions replied that they had "lost no funds at all," and only one said it had "lost significant amounts" to the new accounts being offered by banks and S&Ls.

The shape of the competition and the specifics of the move toward a "supermarket" configuration became clearer when we asked about the specific products. In addition to the share-draft accounts, two-thirds of the credit unions offer mortgage loans. One-fourth already have automatic teller machines—an amazing statistic considering the high cost of these devices—and two-thirds of the rest are considering their installation very seriously.

These credit union managers feel their members really want the ATM and plastic card capability and will leave the credit unions unless they offer these services. CUNA, the industry's trade group, has negotiated open-end contracts with several ATM manufacturers and with a large ATM network provider (ADP-Exchange), and member credit unions are utilizing these connections. More than half of the credit unions we surveyed are either offering or are seriously interested in offering credit cards, while a slightly smaller proportion are investigating debit cards. So these institutions look to such products to broaden the array of services in their move from delicatessen to supermarket.

They are optimistic that they will succeed in this process. Twenty of the 23 credit unions

Question: Between now and 1990, do you expect that your market share will....

Grow	20/23
Remain Stable	3/23
Shrink	0/23

Question: Between now and 1990, do you expect that your profitability will....

Increase	16/23
Hold Steady	7/23
Shrink	0/23

surveyed expected their market share with their customers to grow during the 1980s, and 16 of the 23 expected their profitability to increase. None of the 23 associations expected market share to decrease; only two expected a decrease in profitability. This is particularly interesting in light of the experience these associations already have with the share-draft accounts and their plans to add ATM, mortgage loan, and credit card capabilities.

Other Findings of the Survey

There were other interesting elements of our survey. Unlike banks, credit unions may accept out-of-state deposits. But they are using this capability only rarely. None of the credit unions reported that they had more than 10 percent of their deposits from out-of-state. Two-thirds had less than 5 percent, and the remaining one-third were situated close to their state lines.

These credit unions, with considerable variation, employ approximately one full-time employee for every $1 million in assets. This is considerably higher than other financial institutions and reinforces these institutions' traditional emphasis on personal service and personal contact. Many leaders of the credit union industry privately estimate that a credit union must maintain a spread of 3 percent to 4 percent between the cost of deposits and the interest rates received on loans in order to make a profit.[2] A recent study by Booz, Allen and Hamilton suggests that banks require about that spread or even a little less, while S&Ls require about 2 percent and money market mutual funds require only about 1/2 of 1 percent. All of these services are priced substantially below the fees typically imposed by commercial banks in the same markets.

"Credit unions see commercial banks as their number one competitor."

The survey also suggests that even though credit unions have been able to pay higher interest rates than banks on their savings accounts, and more recently on their share-draft accounts, they have not compensated for this by imposing higher fees for checking account services. This is interesting because many financial industry observers are suggesting that banks and others will have to resort to direct fees to compensate for higher interest rates on deposit funds. Only seven of the 23 credit unions assess monthly charges for checking services

[2]Confirmed by telephone with Robert C. Von der Ohe, Vice President, Economics and Research, Credit Union National Association, May 11, 1983.

Checking Account Fees Charged By Credit Unions

Monthly Fees on Active Shared Draft Accounts
- Number Charging Monthly Fees: 7/23.
- Average Fee: $2.64 per month
- None of the Credit Unions charges more than $5.00 per month.
- Two Credit Unions impose a charge for each check written.

Fees For Returned ("Bounced") Checks
- Number Charging For Each Returned Item: 21/23.
- Average Fee: $8.52 per item.
- One Credit Union charges more than $10.00 per item.
- Two Credit Unions charge less than $5.00 per item.

Fees For Checks Stopped By the Writer
- Number Charging for Each item: 19/23.
- Average Fee: $5.97 per item.
- One Credit Union Charges More Than $10.00 per item.
- Eleven Credit Unions Charge Less Than $5.00 per item.

regardless of minimum, and these charges average $2.64 per month. The associations charge an average of $8.52 for return items and an average of $5.97 to stop a check.[3]

Smaller Credit Unions Somewhat Similar

To see what differences were apparent in the smaller cousins of these large credit unions, we also conducted a supplementary telephone survey of 11 representative small Georgia credit unions whose names were supplied to us by the Georgia Credit Union Central. These credit unions ranged in size from $2 to $8 million in deposits.

Like their larger counterparts, they see banks as their number one competitors; ten out of 11 said so. They are also similar in seeing S&Ls as a somewhat weak second, and in not talking about other credit unions as potential competitors.

Six of the 11 said in telephone interviews that they would be willing to give up some of the personal ties, if necessary, in order to move toward full service banking. The remaining 5 were reluctant to commit to either of the statements mentioned above. So it appears, on the basis of this sketchy evidence, that the smaller credit unions are heading in the same direction as larger associations, but probably not so aggressively.

In comparison to the large credit unions, only seven of the 11 small associations offer the share draft, but most say they are seriously considering the addition of automatic teller machines. None now offers them, which is not a surprise in view of the substantial fixed cost. The associations say they are not seriously considering any other products, such as mortgage loans or credit cards. They also agree with their larger counterparts that regulatory costs have increased (nine out of 11), and they also are fairly optimistic about the future of their money share and their profitability.

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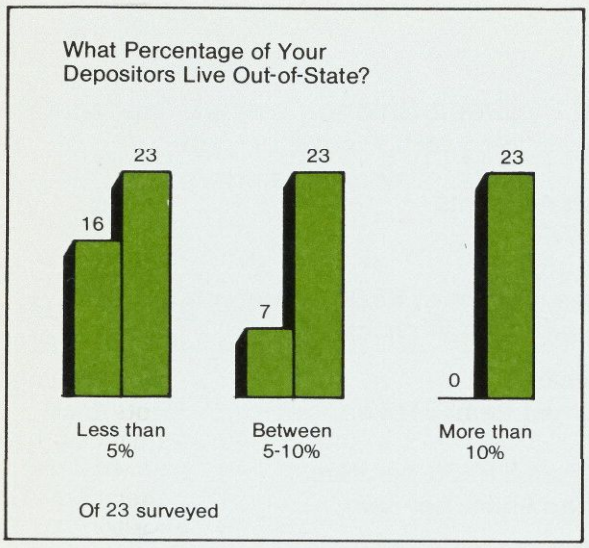
[3] David Whitehead, "MMDAs and Super NOWs: Characteristics and Performance," **Economic Review**, Federal Reserve Bank of Atlanta, June 1983.



Question: During the past five years, the cost of conforming to regulations has....

Increased 20/23
Stayed about the same..... 3/23
Declined 0/23

Where Will It Lead?

Clearly, many larger, well-established credit unions are moving seriously toward a more complete line of consumer financial services. Many have already been successful with share-draft checking accounts, and many report that their customers are asking for additional services, so there is reason to expect success.

On the other hand, these CUs are moving into territory already filled with competitors. Savings and loans, stock brokers and retailers are offering the same services. There is a limited amount of retail financial business to be split among all these competitors. In the end, whether individual associations succeed with this broadening of services will depend on the particular competitive situation faced by each CU and on how well it carries out the move into new services.

—**William N. Cox**