

Share Drafts:

An Investment in the Future

The following three part series by Fred Ringenburg, consultant for Harland, first appeared on *The Point for Credit Union Research and Advice* an online publication of CUNA & Affiliates.

Chapter 1: Share Drafts: An Investment in the Future

Chapter 2: Direct Deposit Can Give Your Credit Union An Added Boost

Chapter 3: New Trends Shape Share Draft Strategies



Chapter 1: Share Drafts: An Investment in the Future

Members with share drafts and direct deposit are key to a CU's financial strength.

Washington Mutual, Bank of America, and many other banks are investing tens of millions of dollars in enhancing and promoting their checking account products. They are making this investment for one reason—customers with checking accounts do more business with a financial institution and contribute more to the bottom line than do non-checking customers.

Increasingly, big bank checking promotions focus on capturing the net paycheck and electronic access. Meanwhile, some credit unions still consider share draft/checking accounts to be an expensive service that detracts from their 'real' business of growing their fields of membership and making more loans to members.

This series of three articles will reveal why credit unions that focus on building share draft account market share are more successful in gaining loan and deposit 'share of wallet' while earning more net income than do credit unions that have lower share draft penetration.

In addition, a specific credit

union case history demonstrates that, among share draft users, those who have signed up for direct deposit are the best of the best in contributing to credit union financial strength. This fact leads to a central conclusion—credit unions need to offer and promote share draft accounts with a full range of payment service options to capture members' net paychecks.

Market Share and Financial Strength—What the Numbers Reveal

To control for the effect of size on sign-up rates, we analyzed year-end 2002 results from all 305 credit unions with between 20,000 and 30,000 members using data from the NCUA 5300 Call Reports. We also standardized all of the results on a per member basis because our goal is to examine the impact of improved share draft penetration on share of wallet.

We found that 99% of credit unions in this size range offer share draft services. The differences as transaction account penetration increases are consistent and substantial as shown in Table 1.

Net income per member

increases 270% as share draft penetration grows from less than 20% to more than 50%. Return on assets (ROA) also increases substantially. Average total deposits per member increase more than 60% with the growth in transaction account usage.

There can be no question that credit unions with high share draft account penetration are also more successful in profit and share of deposits. The growth in average deposit balances, however, is not due solely to the increase in the number of share draft accounts.

Average per account share draft balances actually peak in the 20% to 40% sign-up range. More aggressively promoting share drafts may result in an increase in the number of secondary and inactive share draft accounts. The slightly lower average share draft balances, however, are more than offset by increases in other deposit balances and by increased loan usage (Table 2).

Table 2 shows that the number of loans per member and the total value of the loans nearly double from low to high share draft penetration levels.

When we examine the average credit card, auto loan, and real

Table 1:
Checking Account Usage

Sign-up Rate	% of CUs in Category	Net Income/Member	ROA	Avg Deposit Bal./Member	Avg Checking Bal./User
Over 50%	25%	\$79.64	1.09%	\$6,685	\$1,740
40%-49.9%	34%	\$67.15	0.92%	\$6,112	\$1,807
30%-39.9%	25%	\$52.93	0.83%	\$5,221	\$1,907
20%-29.9%	12%	\$49.51	0.86%	\$4,917	\$1,912
Under 20%	3%	\$29.43	0.60%	\$4,087	\$1,208

**Table 2:
Lending & Checking Usage**

	# Loans /Member	Total Loan \$/Member	% Members w/Credit Cards	Avg Credit Card \$/Account	% Members Auto Loans	Avg Auto Loan \$	% Members RE Loans	Avg RE Loan \$
Over 50%	0.56	\$4,626	20.63%	\$1,526	15.35%	\$10,226	4.89%	\$47,896
40%-49.9%	0.50	\$4,454	16.44%	\$1,549	16.01%	\$10,175	4.20%	\$53,834
30%-39.9%	0.46	\$3,793	15.67%	\$1,581	14.33%	\$9,953	3.68%	\$46,370
20%-29.9%	0.41	\$3,313	11.51%	\$1,398	13.06%	\$9,591	3.06%	\$48,451
Under 20%	0.30	\$2,152	7.13%	\$1,780	6.40%	\$9,786	1.52%	\$51,841

estate loan balance, we see relatively small differences in the size of loans held by members at credit unions, which are more or less successful in promoting share draft services.

Instead, we see that the level of usage of loans is higher in credit unions that are successful in promoting share drafts. From this we conclude that the financial usage patterns of members in the various credit union penetration levels are similar.

Consequently, the difference in the bottom line success of credit unions that sell more share draft accounts is in serving more of the overall financial needs of their

members (increased share of wallet).

Providing full service to more members will increase a credit union's expenses per member (Table 3). However, the net income earned more than offsets the extra expenses.

Fee income increases with share draft account penetration. In fact, according to *CUNA's 2002 Fees Survey Report*, on average, 40% of credit union fee income comes from overdraft fees.

Employee cost and other operating expenses nearly double with increased share draft penetration. However, since high share draft account penetration credit unions

have higher uses of all products, the extra cost can't be attributed solely to share draft services.

The average amount spent per member promoting the credit union is only \$3 to \$4 higher for very successful compared to less successful credit unions in this size range. Thus, a relatively minor additional investment in share draft account promotions can have a major pay-off for the credit union.

Credit unions with 20,000 to 30,000 members that have penetration levels of 30% or less spend an average of about \$130,000 while those with higher penetration levels spend about \$220,000 per year promoting credit union services.

**Table 3:
Expenses & Checking Usage**

	Net Income /Member	Fee Income /Member	Employee Cost/Member	Promotional Cost/Member	Other Op. Expense/Member	Expenses Net of Fees
Over 50%	\$79.64	\$55.95	\$127.15	\$9.27	\$118.94	\$199.42
40%-49.9%	\$67.15	\$54.84	\$121.06	\$8.99	\$110.62	\$185.83
30%-39.9%	\$52.93	\$46.21	\$104.08	\$8.70	\$97.33	\$163.91
20%-29.9%	\$49.51	\$36.97	\$90.78	\$5.52	\$86.56	\$145.90
Under 20%	\$29.43	\$18.21	\$70.79	\$5.16	\$68.73	\$126.48

Chapter 2:

Direct Deposit Can Give Your Credit Union An Added Boost

Members with share drafts and direct deposit are key to a CU's financial strength.

Among share draft account users, those who have signed up for direct deposit are the best of the best in contributing to credit union financial strength, according to a credit union case history. This fact demonstrates that credit unions need to offer and promote share draft accounts with a full range of payment service options in order to capture members' net paychecks.

We recently reviewed marketing customer information file (MCIF) data from a \$1 billion asset East Coast credit union with more than 100,000 members. Our objective was to determine the additional bottom line and share of wallet impact of direct deposit and/or automated clearing house (DD/ACH) sign-up on a credit union's performance.

In Table 4, we see that moving

from members with no share draft account to those with share drafts but without DD/ACH services and finally to share drafts with DD/ACH adds to the credit union's share of wallet and net income.

Profitability increases by 40% just by signing the member up for share drafts and more than doubles when DD/ACH service is added. Electronic service (debit card, phone banking, bill paying, and ATM) usage is substantially higher for share draft users and even more so for DD/ACH users.

Members with DD/ACH have average share draft balances more than twice as high as other share draft account holders. They are also much less likely to have an inactive (\$0 balance) share draft account.

Total non-share draft deposit dollars are similar for those without share drafts and those with share drafts but without ACH/DD. Adding ACH/DD services increas-

es deposit balances by 75%.

The average total amount of loans is similar among the three groups; however, the probability of actually borrowing is twice as high among both share draft account groups.

The data in Table 4 is illustrative of the kinds of detailed probing of share draft account services that could be undertaken to understand the best combination of payment products and services.

Similar analysis could be applied comparing the relative levels of success of different types of share draft services such as dividend paying versus non-dividend or minimum balance versus no-minimum balance requirements.

Ideally, in future research, the analyzed results from many credit unions will be combined to be able to better predict the outcome of offering specific features of payment service products.

Table 4:
Product Service Usage By DD/ACH Usage

	No Checking, No DD, or ACH	No ACH or Checking w/o DD or ACH	Checking w/DD or ACH
Member Profitability	\$281	\$389	\$674
Debit Card User	13.3%	58.5%	68.9%
Phone Banking User	49.2%	72.6%	86.1%
Bill Payer User	0.2%	2.0%	5.6%
ATM User	38.0%	57.3%	72.7%
Total \$ Checking	\$0	1,365	\$3,122
Inactive Checking (\$0 balance)	n/a	19%	2%
Average non-checking deposits	\$9,260	\$9,939	\$17,406
Average \$ Loans	\$41,115	\$36,077	\$41,671
Average # Loans / Member	.220	.552	.521

Chapter 3: New Trends Shape Share Draft Strategies

Taking another look at promoting share draft accounts.

Based on the increased level of bottom line success of credit unions with high levels of share draft account penetration, it's apparent that credit unions should once again turn their attention to promoting full service relationships based on an expanded concept of share draft account services.

In the past 29 years, credit unions have opened more than 30 million share draft checking accounts. A large part of the growth has been the result of the better value offered by credit unions. Banks have understood this strategy and are now promoting their 'free' share draft options—as illustrated in a *New*

York Times article "Checking Is Free, but the Profits Are Hefty" (Nov. 12, 2002). Moving beyond simple free checking, Bank of America has signed up over 2 million of their nearly 5 million on-line customers to use their free bill-paying system.

Many other banks are investing tens of millions of dollars in enhancing and promoting their checking account products. They are making this investment for one reason—customers with checking accounts do more business with a financial institution and contribute more to the bottom line than do non-checking customers.

Future credit union market share gains will require retaining the 'good value' position while continually enhancing payment products through:

- Better understanding of con-

sumer needs;

- Societal trends;
- Technological applications;
- Marketing strategies;
- Operations/customer service;
- Money management requirements; and
- Risk management.

• Checking Into The Future

We are in the planning process for launching a new initiative, "Checking Into The Future". The goal is to provide credit unions with the support services necessary to continue to grow credit union share of wallet through enhanced checking account product features and marketing techniques. You can help direct our efforts through ranking the importance to you of each of the following potential services. See the next page. Please fax your response to 603-754-5837.

Checking Into the Future

Name: _____

Credit Union Name: _____

Phone: _____

Please rate how important each potential service would be to your credit union.

	Very Important	Somewhat Important	Not Important
Economic analysis of checking and related services			
Marketing examples and case histories			
Reports on competitor products			
Enhancements to on-line banking services			
Survey research on member payment system preferences			
Documentation on business checking account requirements			
On-line discussion groups concerning payment services			
Evaluations of debit card services			
Review of club account products			
Analysis of Money Management Software (e.g. MS Money & Quicken)			
Enhancements to checking account operations			

Please fax this form to Fred Ringenberg at 603-754-5837.

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ABOUT THE AUTHOR

Fred Ringenburg is a former CUNA & Affiliates employee. He undertook the original survey research that led to the establishment of the first share draft programs in 1974 and later became Vice President of Transaction Systems for CUNA Service Group.

In 1984 he went to work for a predecessor to the Harland Company (CUNA's endorsed check printer) as manager of the Credit Union Division. He helped establish Scantron's Survey Services Division.

For the past five years Fred has been an independent consultant primarily serving financial institution customers of Scantron and Harland. In that role he has conducted research and analysis for over two hundred fifty credit unions, banks, insurance companies and mutual funds.