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Cross Usage of Banks and Credit Unions

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Abstract

Federal Credit Unions (FCU's) represent a growing part of consumer banking in the United States. They are aggressively seeking new customers in many markets, and are no longer the financial institution of choice for only company/organization employees who have very unsophisticated financial needs. This article examines survey data from almost 1,7000 households in a mid-sized US city to explore the degree to which consumers use both credit unions and banks across several debit and loan products.

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1 Introduction

In 1998, following a Supreme Court decision that struck down an attempt to liberalize membership rules for credit unions, Congress passed new legislation overriding the court's decision and created a distinct competitive advantage for these once highly-regulated financial institutions. Now credit unions not only had a cost advantage over banks due to their non-profit tax status, but they could also expand their reach geographically with relatively few restraints. The result was a period of consolidation, merger, and an expansion of geographic markets, followed by increasing competition with commercial banks.

Despite these advantages, credit unions sometimes lack expertise in market research, promotion strategy, and product development.

Further, their management often exhibits an attitude of moral superiority to banks which may cause them to overlook the necessity of employing standard marketing practices in

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order to increase their market penetration.[5] In the new competitive environment, they will have to better understand the demand for their products, how to make best use of their competitive advantage, and how to create increased value for consumers.

Banks, on the other hand, often also have an attitude of superiority vis-a-vis credit unions, seeing them as serving an unsophisticated local niche with similarly unsophisticated management. This sense of complacency is enhanced by FDIC market share statistics, which do not include credit union deposits and which there promulgates the view that credit unions are not a competitive threat. It is not unusual for banking managers to severely under-estimate the market shares of their credit union competitors.[6]

Thus, both banks and credit unions need to better understand their competitive interface. Our study takes a step in that direction by exploring the degree to which consumers use both credit unions and banks across several debit and loan products.

The paper also addresses the issue of share of wallet. Share of wallet (SOW) has become an important metric in this age of focus on customer satisfaction, customer loyalty, and Customer Relationships Management. As noted especially by Du, et al. (2007), a critical issue for financial institutions seeking to maximize the benefit of their customer relationship expenditures, a critical issue is how to determine what customers with low profitability relationships have the potential for becoming more important customers through the identification and relocation of assets held outside the focal financial institution.

2 Literature Review

The influence of credit unions on local banking competition has been investigated empirically in a number of papers. Overall, the empirical studies find that credit unions indeed matter for the degree of concentration in local deposit markets (Emmons and Schmid 2000), for deposit rates (Tokle and Tokle 2000, Hannan 2003) and bank loan rates (Feinberg 2001, 2002 and Feinberg and Rahman 2001). Furthermore, Emmons and Schmid (2000) and Feinberg and Rahman (2001) find that there is causation running in both directions: from banks to credit unions and the reverse. Schmid (2005) investigated the nature of competition between commercial banks and credit unions financial institutions, both theoretically and empirically. The theoretical model showed that greater participation in credit unions is associated with higher levels of retail-banking concentration. This hypothesis was supported by empirical evidence for the period 1990-2000, but not for 2001-2002 period. The ability of credit unions to affect local banking market structure supports the concept that banking competition is still local in nature.

Regarding share of wallet, Du, et al. (2007), provide direct evidence that transaction levels inside a firm alone are largely uninformative with respect to a customer's transaction levels outside the firm. Garland (2004) examined the role of share of wallet in predicting customer profitability, finding that it is the single relationship-based measure with the most impact on customer contribution. Baumann, Burton, and Elliott (2005) use survey data to identify customer characteristics that are associated with high share of wallet in retail

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[5] Conversation by first author with industry consultant who was formerly a marketing vice president with both banks and a credit union.

[6] ibid

banking, and Garland and Gendall (2004) use share of wallet as a factor in predicting customer behavior.

3 Methodology

Data was collected from 1,699 adults 18+ in a mid-sized US city via an online consumer panel. Data was collected over a one-month period on a quarterly consumer finance survey, with approximately one fourth of the sample being collected in each collection period.

The panel provider, Harris Interactive, Inc., is one of the world's largest online panel companies. Respondents receive "prize points" that can be accumulated and redeemed for gifts. Harris Interactive controls the frequency with which respondents receive questionnaires so as to prevent respondents from becoming "professional respondents" (by having the opportunity to take an excessive number of surveys) and also by providing enough opportunities to keep panel members interested and proficient at completing online surveys.

Although the financial services survey collects information on approximately twenty financial products among three categories (deposits, loans, and investments) as well as banking behaviors, this paper is limited to a smaller number due to low sample sizes for some of the individual products (e.g. annuities).

Table 1 provides a demographic breakdown of the survey respondents. The main skew between the area population and the sample is the over-representation of female responses. Slightly over 60% of the respondents are female whereas women account for slightly more than 50% of the population.

4 Findings

4.1 Primary Financial Institution and Incidence of Accounts

As a frame of reference, respondents were asked to identify their "Primary Financial Institution". This measure commonly is considered a highly desirable designation, as it is the institution that respondents typically think of first when increasing their current relationship or shopping for additional financial products.

As shown in Table 2, about one third considers a credit union to be their primary financial institution while two thirds consider a bank to be their primary financial institution. While we do not have benchmark data to evaluate the degree to which our focal city is typical of all US cities, we believe that most observers would be surprised by the large share held by the credit unions. This represents a significant amount of financial resources. (It should be noted, however, that about two thirds of the credit union market share is held by just one institution, which may not be typical). This clearly shows that credit unions are not just niche players in the competitive arena in this city.

Table 1: Respondent Profile

	Total	Bank focused*	Credit union focused*
Percent female	61.6%	62.6%	61.1%
High school grad or less	14.7%	11.7%	16.1%
Some college	37.2%	38.8%	36.4%
Four year degree	21.4%	22.3%	21.0%
Grad school	26.8%	27.2%	26.6%
Percent Caucasian	93.0%	90.8%	94.0%
Age 18 to 34 years	23.6%	20.9%	24.9%
35 to 44	18.2%	19.4%	17.6%
45 to 54	23.7%	23.7%	23.7%
55-64	21.8%	24.3%	20.6%
65 and up	12.8%	11.7%	13.2%
HH income under $35K	24.2%	21.6%	25.2%
$35K to under $75K	41.5%	46.1%	39.4%
$75 to under $100K	14.5%	14.2%	14.6%
$100K and over	19.8%	18.1%	20.8%
(Percent refused)	(14.7%)	(17.6%)	(13.2%)
*Classification on respondent’s expressed type of “Primary financial institution”			

Table 2: Primary Financial Institution

Credit Union	32.6%
Bank	67.4%
Total (n= 1699)	100.0%

Six types of accounts – four deposit and two loan – were reviewed in this study. Their incidence of usage is shown in Table 3. Naturally, checking accounts are the most widely held, followed by savings accounts. The incidence of other accounts is much lower.

Table 3: Types of Accounts Held by Respondents

	% with account
Deposit	
Checking	92.3%
Savings	76.5%
CD	23.4%
Money Market	18.4%
Loans	
Home equity loan/ line of credit	23.3%
Auto loan	42.0%
Mortgage	46.5%

4.2 Cross Usage of Accounts – Credit Unions vs. Banks

To what extent are both types of institutions used by consumers? Table 4 answers this question, showing the percent of respondents for each type of account who have only credit union accounts, only bank accounts, and those who have both credit union and bank accounts. It shows that checking and savings accounts are most likely to experience dual usage. Eighteen percent of those with a checking account and sixteen percent of those with a savings account actually have accounts at both a credit union and a conventional bank. (It is quite possible, of course, that consumers are rate-shopping within their account type. Thus, credit union only customers may look for better CD rates among multiple credit unions.)

Table 4: Cross Usage of Accounts

Account	CU only	Bank only	Both	Total
Checking	23.6	58.2	18.2	100.0%
Savings	33.6	50.4	16.0	100.0%
CD	31.9	65.6	2.5	100.0%
Money Market	35.1	59.4	5.4	100.0%
Home equity loan/line of credit	35.9	62.7	1.4	100.0%
Auto loan	37.3	54.4	8.3	100.0%

One might hypothesize that there would be more cross usage for CD, money market, home equity, and auto loan accounts, as these are likely to be rate driven. As noted earlier, credit unions have a cost advantage that typically allows them to offer better rates. However, their cross usage is well below ten percent, except for auto loans at 8.3%.

4.3 Cross Usage by Credit Union and Bank Customers

Those who state that their primary financial institution is a credit union are much more likely to use both banks and credit unions for checking and savings accounts than are those whose primary financial institution is a bank (Tables 4a, 4b).For example, 28.5% of those who state that their primary financial institution is a credit union have checking accounts with both banks and credit unions, and another 2.4% have a checking account with only a bank. On the other hand, only 13.8% of those who say that a bank is their primary financial institution have checking accounts with both types of financial institutions and 1.4% have a checking account with only a credit union. Overall, both credit union and bank customers are most likely to use their type of financial institution for all products examined, but credit union customers are more likely to use bank products than are bank customer to use credit union products.

Table 4a: Credit Union Customers

Account	CU only	Bank only	Both	Total (n)
Checking	69.1	2.4	28.5	100.0% (501)
Savings	76.3	2.4	21.3	100.0% (465)
CD	69.1	27.0	3.9	100.0% (152)
Money Market	74.0	17.3	8.7	100.0% (104)
Home equity loan/ line of credit	65.2	34.1	0.7	100.0% (135)
Auto loan	59.3	33.5	7.3	100.0% (248)

4.4 Average Account Value

Table 5 shows the average account value for deposit products, and remaining loan amount for loans products according to type of account. The data show no consistent relationships among the three types of financial institutions where accounts are held. In some cases, the highest values are for those respondents with only credit union accounts (e.g. home equity loans/lines of credit), sometimes for bank only respondents (e.g. checking), and sometimes for those with accounts in both types (e.g. money market accounts).

Table 4b: Bank Customers

Account	CU only	Bank only	Both	Total (n)
Checking	1.4	84.8	13.8	100.0% (1007)
Savings	8.5	77.7	13.8	100.0% (790)
CD	8.4	89.9	1.7	100.0% (238)
Money Market	15.5	80.5	4.0	100.0% (200)
Home equity loan/line of credit	17.2	80.9	1.9	100.0% (209)
Auto loan	25.9	65.5	8.6	100.0% (441)

Table 5: Average account values

Account	CU only	Bank only	Both
Checking	$2,201	$4,581	$4,404
Savings	$4,797	$9,304	$6,443
CD	$4,568	$4,041	$6,119
Money Market	$6,045	$7,561	$8,263
Home equity loan/line of credit	$20,995	$20,537	$15,250
Auto loan	$16,466	$17, 035	$20,331

4.5 Share of Wallet

Share of wallet is a critical issue for any financial institution seeking to increase its market share. Table 6 shows a special calculation of share of wallet from the perspective of two institutions – the areas' highest share credit union and the highest share bank. It shows, for example, that customers of the most popular credit union have 49.8% of all of their checking account balances with that particular credit union, while customers of the area's most popular bank have 45.6% of their checking account balances with that one particular bank.

Table 6: Share of Wallet (Based on dollars)

Account	Most Popular CU	Most Popular Bank
Checking	49.8%	45.6%
Savings	53.0%	42.1%
CD	55.2%	33.3%
Money Market	45.7%	23.6%
Home equity loan/line of credit	56.5%	18.1%
Auto	38.8%	5.6%

5 Discussion

The changes made by Congress in 1998, which liberalized membership rules for credit unions, created an extraordinary opportunity for these financial institutions to extend their reach to a far larger customer base, to leverage their operational advantage as a non-profit, tax-exempt entity, and thereby increase their profits. But to do so, they will have to create points of differentiation that have utility to customers and distinguish themselves from their primary competitors, commercial banks.

Notably, one third (32.6%) of the respondents in this study said their primary financial institution was a credit union. That's a large market share for institutions that have long been considered niche players, with limited visibility in the marketplace. On the other hand, their target market has historically been well-defined and easily accessible, an advantage over commercial banks that they will forego if they chose to grow their market, and the reason why the authors believe that they will have to make a bigger investment in market research.

Our analysis shows that cross usage between credit unions and banks is limited. Only in the case of checking (18.2%) and savings (16%) accounts did customers preferring one type of institution also patronize the other to any extent. Apparently, consumers are less loyal to their primary financial institution when it comes to these more familiar products. Given the pricing advantage available to credit unions, a strong promotional program might increase their market share for these products and perhaps provide additional exposure for their other investment and credit products. In the current economic environment, price elasticity of demand will increasingly favor the institutions that offer the highest rate of return. And, of course, there is no reason that this should not be the case for other products offered by credit unions, especially if differentiation is achieved through the addition attractive features and the use of effect market segmentation.

Surprisingly, customers citing credit unions as their preferred financial institution crossed over more than those favoring banks. This was the case for all products, and it surprised us because, since credit unions are thought to appeal to niche markets, often comprising customers with a common allegiance (e.g., individuals who work for the same industry, or even the same company), it was thought that their customers would be more loyal to their financial institutions than would those who preferred banks. These findings suggest otherwise: maybe credit unions have become a little complacent about the need to cultivate customer loyalty.

The average value of account balances (including indebtedness) of the six products, for each type of institution, varied most with checking and savings accounts, where the average bank balance was twice as high for checking ($2,201 vs. $4,581) and nearly twice as high for savings ($4,797 vs. $9,304). Here, again, it would seem that the better interest rates typically available at credit unions would prompt savers to put more of their funds in credit union saving accounts. But the reason for these differences may have more to do the differences in amount of discretionary income available to save, or the propensity to save, between those who use credit unions, and those who use banks. Or they could be due to the differences in products or marketing strategies of each type of institution.

Data on Share of Wallet show a significant difference in that average proportion of each client's assets, by product type, that each institution was holding (including debt). The differences were clear in every case, with credit unions consistently holding the larger share. The difference was greatest in the case of CDs, Money Market Certificates and Home Equity Lines of Credit. To the extent that these results are indicative of the differences in SOW for all such institutions, this would be very good news for credit unions.

In the case of these results, which could be anomalous, and thus not reliable, the data are presented to illustrate the importance of this metric. Although market share is very important in increasing profits, increasing the share of existing client assets can also increase total holdings and profits as well. Marketing to existing customers, often neglected in favor of expanding market share or developing new markets, can be a very cost-effective way to build loyalty while assuring a stable customer base and an increase in near-term profits.

The bank in this case might have a good opportunity to increase its profits if it were aware of its relative SOW. In a sense, it's leaving money on the table by neglecting to capitalize on existing relationships – to say nothing of the data about these existing clients that could be exploited – to increase holdings.

6 Conclusions

The results of our study show that there are opportunities for both banks and credit unions to attract customers who mainly patronize institutions of a different type. This is especially true for credit unions where banks have substantially higher average balances on checking and savings accounts, and for banks in the areas of certain investment and loan products where their share of wallet is relatively low.

The authors believe that, by building on what we have learned by augmenting our findings with additional market research, creating new and improved products, and understanding the strengths and weaknesses of competitors, credit unions could become a more dominant force in the financial services marketplace. The same could be true for banks, although we believe that they have a head start in this arena and recognize the value of good market research.

Thus future extensions of this research could include developing and testing models predicting patronage of institutional type and associated share of wallet models.

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