

# Another Way to Look at “Member Value”

by Suzanne Collier and Philip Heckman

The average member is getting older. Loan demand is fading. We need to find borrowers and collect more fees. More and more, this financial balancing act feels like a plunging roller coaster rather than an undulating ocean wave.

We all look at our shrinking margins and wish that we had more “profitable” members. Following the conventional wisdom of the “90-10 Rule” (known as the “80-20 Rule” in some circles), we assume that 80% to 90% of the revenue supporting our credit unions comes from 10% to 20% of our members.

But is that rule of thumb true? How well do we measure member value? Should we ignore youth, abandon seniors, and pursue the “profitable” adults in between?

What follows is an examination of “member value” at Resource One Credit Union, Dallas, using a Marketing Customer Information File (MCIF) on its 40,000 member records. The MCIF is powerful, but expensive and cumbersome, and we suggest a simpler measuring tool. But first, let’s look at what other sources tell us about keeping financial institutions in the black.

## Bank statistics

There are mounds of bank statistics predicting a customer’s future value over a lifetime. Banks call this “Customer Lifetime Value.” For example, the Fort Lauderdale, Fla.-based Database Marketing Institute (DMI) recently published a study by Arthur Middleton Hughes called “How Banks Use Profitability Analysis.” Hughes uses Boston-based Fleet Bank as his subject. His findings suggest that account balances are only loosely correlated with profitability and that demographics are even more poorly correlated.

The truth is that one-half of Fleet’s customers are unprofitable, and that 20% are very much so. The bottom 28% of customers bring losses that offset 22% of the bank’s annual profit. Worst of all, Fleet’s marketing staff is working hard to acquire and retain these customers. One-half of new accounts will never yield a profit.

Relationship marketing assumes that a business remains profitable by identifying the best customers and investing disproportionate resources

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in them. Because credit unions have traditionally treated all members equally, we’ve been slow to adopt this type of service philosophy. However, this assumption does not seem likely to stand the test of time or of profitability analysis.

Fleet assigns personal bankers to provide five-star services to its most-profitable customers. It equips special service teams with products designed to attract and satisfy these “gold” customers. However, it is almost impossible to cross-sell the most-profitable customers. Indeed, most of these sales cannibalize existing profitable products.

The Fleet study generates these intriguing conclusions and questions:

- Some unprofitable customers can become profitable with the right products at the right prices at the right times. For example, Fleet finds that the typical customer generates

an annual profit of \$63, due mainly to mutual fund investments. Without investment fees, this kind of customer would mean a \$166 loss to the bank. How many financial institutions offer mutual funds? What other services provide a “perfect fit” for customers as they age?

- Some low-profit customers have great potential because they are high-profit customers at another bank. For top customers, marketing should focus on retention, not cross- or up-selling. What practices cause potential lifetime customers to migrate to other financial institutions? Does a concentration on fee income thwart business growth?

- Policies that turn away unprofitable customers can turn off profitable ones also. For example, customers who visit branch offices cost money. It’s much more economical to have them using an ATM, the U.S. mail, or PC banking. For this reason, some financial institutions have tried to discourage branch visits by charging a fee. But unless you know precisely who’s using your branches, how can you prevent the loss of desirable business?

- Some customer profits and losses are temporary and reversible. Researchers Edward C. Malthouse and Robert C. Blattberg of Northwestern University say that “...a firm cannot assume that high-profit customers in the past will be profitable in the future nor can they assume that historically low-profit customers will be low-profit in the future.” According to Hughes’ DMI study, more than one-half of Fleet’s unprofitable customers have the potential to generate a profit. Furthermore, Hughes concludes, “Profitability only measures the past. Lifetime value projects this into the future...”

Here’s what we find when we use

**Table 1**  
**Average Annual Member Value by Service Use**

	Percent of All Members Using	Average AMV
1 Service	31.2%	(\$89)
2 Services	51.1	90
3 Services	12.7	184
4+ Services	5.1%	\$513

**Table 2**  
**Average Annual Member Value by Age**

	Number of Members	Average AMV
<18	3,652	(\$120)
18-24	2,732	22
25-34	6,463	159
35-44	9,535	161
45-54	9,307	90
55-64	5,169	26
65+	3,526	(\$125)

Resource One's MCIF to rummage through its database.

**Member value at Resource One CU**

The credit union equivalent of the banks' "customer value" is "member value." First of all, Resource One's data, like Fleet's, refutes the 90-10 rule. Fully 45% of Resource One's members produce a positive Annual Member Value (AMV) or—as bankers put it—a profit.

We compare average AMVs by service use (Table 1) and age (Table 2).

At first glance, the results seem to contain few surprises. The more services that members use, the more net revenue they generate (Table 1). Just as we expected, AMVs peak during what is commonly known as the "prime borrowing years" (ages 25 to 44, Table 2) because of mortgages and new- and used-auto loans. After that, the older that members become,

the less revenue they generate per year.

Resource One CU's MCIF report seems to do little to further the argument for bringing in young members or holding on to old ones. Members under the age of 18 and over the age of 65 cost Resource One CU money, just as conventional wisdom says.

But maybe there's more to it than that. Seniors, who are net savers, provide the funds to make loans to those 25-to-44-year-olds—loans that generate revenue. Resource One CU's

loan-to-savings ratio is usually near 100%. Without our seniors, we'd have to borrow to meet loan demand. We simply need to look for more revenue-producing services, such as annuities, that match older members' needs.

The youth numbers offer a similar hidden conclusion.

### Youth: the long-term solution

Resource One has a youth club for children from birth to age 12 (with

1,345 members). It also has a club for teenagers aged 13 to 17 (935 members). MCIF analysis reveals that AMV varies a great deal within Resource One CU's under-18 membership. Unlike with their parents, youth AMVs (Tables 3 and 4) don't increase as their business does. Considering the four services available to minors at Resource One—savings accounts, checking accounts (debit cards, home banking, bill pay, and overdraft privilege are standard), CDs and co-signed loans—only the last has revenue potential. (Resource One doesn't want youth checking accounts to generate NSF fees, for example.)

Resource One's youth accounts promise to provide the best relationships over time. Three years after launching its youth programs, the credit union has almost zero attrition. As young members grow and take advantage of appropriate products and services, Resource One prepares them for positive revenue contributions, which begin after age 18 (Table 5).

For years CUNA's "Environmental Scan" has been showing that credit unions should be bringing in younger members. Marketers talk about reducing the average age of the membership and sustaining a good lending base.

When we ask members, "Where did you get your first loan or savings account?" Invariably the answer is: "My mom and dad opened a credit union account for me when I was young. I'm still a member." We can see that to reduce the age of our members, we need to provide services and products for a younger crowd.

Increasing overall average AMVs is key to credit union success, especially when the AMVs of so many adult members are negative. We have to identify the products that increase the AMVs of all ages. We have to offer the services that they need during the various phases of their lives. Only then can we turn negative AMVs into positive ones.

The pattern of Annual Member

**Table 3**  
**Average Annual Youth Club Member Value by Service Use (Birth to Age 12)**

	Percent of Members Aged Birth-12 Using	Average AMV
1 Service	88.2%	(\$103)
2 Services	11.5	(231)
3 Services	0.3	(\$181)
4 Services	0%	—

**Table 4**  
**Average Annual Teen Club Member Value by Service Use (Ages 13 to 17)**

	Percent of Members Aged 13-17 Using	Average AMV
1 Service	30.9%	(\$101)
2 Services	51.0	(37)
3 Services	12.9	(153)
4 Services	0.1%	(\$331)

**Table 5**  
**Average Annual Member Value by Service Use and Age**

	Ages 18-24	Ages 25-34	Ages 35-44	Ages 45-54	Ages 55-64	Ages 65+
1 Service	(\$92)	(\$96)	(\$87)	(\$64)	(\$65)	(\$29)
2 Services	10	159	182	106	37	(137)
3 Services	104	361	297	197	96	(186)
4+ Services	(\$44)	\$684	\$895	\$572	\$411	(\$251)

## Marginal Net Revenue Contribution

MCIF software is a powerful tool for asset/liability management, product pricing, and strategic planning. An MCIF can, for example, determine that the most likely prospects for home equity loans are people between the ages of 37 and 48 who have lived in their homes for 14 years or more.

MCIFs deal with averages and cohorts, and calculate profitability of services first, then use those numbers to determine customer value. But for some questions—such as “Is our youth club worth the expense?”—using an MCIF to find the answer seems a bit like flying the Space Shuttle to the corner grocery for a loaf of bread.

We propose an alternative, complementary way to measure member value. It uses data that credit unions already collect, but don't aggregate. In fact, most credit unions report member value data monthly. They just don't look at it.

Simply put, a member's business is worth what she pays the credit union minus what the credit union pays her. You can express this relationship with a simple formula:

### Marginal Net Revenue Contribution

= Total Loan Interest Paid (Most-Recent Year)

+ Total Fees Paid (Most-Recent Year)

– Total Interest & Dividends Earned (Most-Recent Year)

True, this is a crude measure. True, it ignores all the minutia of time and materials and overhead expense that MCIFs chew up and spew out. And it doesn't say anything about the profitability of specific services. But consider what the Marginal Net Revenue Contribution (MNRC) formula could reveal if applied over an entire year. It would paint a current picture of the dollar value of that member's annual business. The greater an individual's MNRC—even if she's at the “unprofitable” ends of the age spectrum—the more she contributes to the credit union's current business viability.

Knowing individual MNRCs, a credit union's primary goal would be to raise each new member to the annual breakeven point and beyond through increased service use.

The beauty of the Marginal Net Revenue Contribution lies in its simplicity. All the data needed to derive it appear on existing monthly statements. All a credit union needs to do is sweep this monthly information into an annual summary file for each member. The result would be an annual measurement of each member's current donation to the cooperative's health.

“Lifetime data look backward,” CUNA economist Steve Rick points out. “Who cares if a particular member was unprofitable 20 years ago, or even last year? If you're still in business, you obviously survived it. The important thing is serving that member cost-effectively this year and next. Business decisions are best made using marginal benefit/marginal cost analysis, and this measure could help you do that.” MNRCs would enable a credit union to more easily:

- Compare groups of members on their actual—not average or theoretical—net revenue production.
- Evaluate youth and adult member education programs by comparing the current net revenue contributions of those who participated to those who didn't (after controlling for variables such as age and household income).
- Identify members with below-average net revenue contributions, with an eye to increasing their productive service use.

We plan to collect and analyze MNRCs at Resource One CU. We'll also look for a way to use MNRCs to calculate member “profitability” (perhaps in relation to the credit union's annual net income). And we encourage other credit unions to dig through conventional wisdom for other ways to look at member value for the long-term health of the movement.

Values over the age spectrum provides the best argument for getting youth to join the credit union and persuading them to stay. Because many banks, bogged down by conventional wisdom, are neglecting youth, credit unions can have them all to ourselves. Introducing youth to financial services and keeping them until their AMVs are positive is a long-term solution, not a quick fix. It takes time to lower the average age of membership. We lament our members' high expectations and desire for immediate gratification. Well, guess what? Credit union boards and upper management think the same way.

Marketers get geared up about the youth market because they believe that is where the future growth and health of their credit unions lie. Younger members are more accepting of e-services. But investing in new delivery channels may prove to be difficult because CEOs and directors tend to be older and less likely to use remote service delivery. They look at negative youth AMVs, and decide to spend marketing dollars for a quicker effect on the bottom line. But in fact, by not investing in technology, our overall membership will age faster than expected.

Resource One CU staff will continue to use its MCIF to make sure that services remain “profitable.” But the credit union will also be working on a simpler measure of success (see sidebar “Marginal Net Revenue Contribution”). After all, Resource One's primary goal is to prepare all members to be financially literate, responsible, and secure. That's how credit unions define “profitable endeavor.” ■

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