Callahan's Return of the Member Index: Quantifying Member Value

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"Our organizational commitment remains to create real, tangible, and measurable economic value for our members, to expand our presence and relevance in the communities we serve..." shared the CEO of a large Arizona credit union.

The above quote exemplifies how credit unions are organizations that focus on their member/owners, and not shareholders. Due to their not-for-profit nature, credit unions can maximize the value provided to their members at the expense of the bottom line. Some net income is necessary for future product and capital investments, but overall, credit unions are not profit-driven institutions. The industry prides itself on offering the best rates, products, and service to its members. Providing the highest member value possible is what differentiates credit unions from the rest of the financial services industry. But how do credit unions quantify their member value?

Are the credit union's loan rates lower or deposit rates higher than its competitors? How many products and services does the credit union offer? And how many members are using these products? Because credit unions continually strive to improve their member service, whether by offering new savings options, competitive loan rates, or a wider variety of services, a more comprehensive view of member value is needed. Callahan's Return of the Member measure attempts to capture all of these aspects. "I use Callahan's Return of the Member scores with my staff and Board of Directors to track the progress we are making at the credit union," Diana Dykstra, CEO of a $500 million credit union in San Francisco said of this measure.

How did Callahan's Measure Come About?
More than 88 million members are currently served by credit unions. Despite this being almost 30 percent of the U.S. population, credit unions only manage to hold less than 6 percent of total financial assets in the nation. Providing more value-added services to members continues to be credit unions' most important initiative. In 1996, Callahan & Associates, a credit union research and consulting firm based in Washington, D.C., developed a scoring system to look beyond the traditional safety and soundness issues that the NCUA's CAMEL scoring, and others, examined. This score provides a more holistic view of member value using data from the 5300 Call Report.

The Return of the Member (ROM) index came about when a credit union board of directors asked their CEO to explain a $1 million drop in net income over a year. The CEO explained that the drop was due to an increase in dividend payments to the members. Therefore, the year was still satisfactory, but the net operating results had been distributed differently. The members, not the credit union, received the earnings. A board member then continued to stress, "How do you measure return of the members?" Callahan & Associates heard this question and acted.

The Core Components of ROM

This member value metric has been altered and re-weighted over the years to reflect the evolution of the credit union industry and the ever-changing call report. Return of the Member attempts to capture all aspects of a member's relationship with the credit union. The ROM calculation considers the three core credit union functions of lending, savings and product usage with three main components: **Return to the Savers**, **Return to the Borrowers** and **Member Service Usage**. The ranking system is an index calculation that takes into account a credit union's performance in comparison with its asset size-based peer group.

Return to the Savers

The first component of the Return of the Member analysis is Return to the Savers. It measures how well a credit union is providing deposit services to its members. In addition to measuring the average dividends paid, this number also takes into account the change in average share balance, the number of share accounts per member and the three-year share growth of the credit union. The change in average share balance highlights the credit unions that are attracting additional shares and capturing momentum in today's slow growth environment. Individual weights of each component are included here:

1. **Dividends / Income** (30%)-- What portion of income does a credit union pay back to its members? This is generally referred to as the payout ratio.

2. **Average Dividends Paid** (30%)-- What is the average dividend at the credit union? This is calculated by taking the total dividends and interest paid on deposits paid by the credit union divided by total shares at the credit union.

3. **Change in Average Share Balance Per Member** (15%) – Are members increasing their savings balance at their credit union? A greater increase yields a higher score.

4. **Three-Year Compound Share Growth** (15%)-- What is the member response to savings offerings over the last three years? The three-year window provides a longer-term view of saving trends at the credit union and can smooth any aberrant results caused by one-time events.

5. **Number of Share Accounts Per Member** (10%) – How are members responding to the savings products that the credit unions offers? Not only is this a measure of how many products offered, but also whether each of them are attractive for the member to use at the credit union and not go elsewhere.

Return to the Borrowers

The lending component, Return to the Borrowers, recognizes that credit unions were created to provide credit to their members at a reasonable cost. The index rewards those credit unions that offer a lower rate on loans, but it also considers the historical growth in lending and the variety of products offered to its members. In recent years, credit unions have started to sell a significant amount of loans to the secondary market. As credit unions become more involved in the secondary market in order to maintain liquidity and increase lending capacity, the loan servicing portfolio was added as a component of the score. By retaining servicing, credit unions are able to maintain closer relationships with their members. So that this activity is reflected in the member relationship, each credit union's mortgage servicing portfolio is added to outstanding loans when calculating the loan-to-share ratio. Individual weights of each component are included here:

1. **Loans + Servicing Portfolio / Shares Ratio (includes mortgage servicing)** (30%) -- How well is the credit union converting savings back into loans? With this also being a measure of liquidity, this can also measure the credit union's capacity to provide more loans.

2. **Yield on Average Loans** (20%) -- Which credit unions are offering the lowest overall yield? Lower loan rates can drive product growth and increase value to the members.

3. **Number of Loan Accounts per Member** (10%) -- Is the credit union providing a wide variety of loan services? And are these services attractive enough to gain usage by the membership?

4. **Three-Year Compound Loan Growth** (15%) -- What is the member response to the lending programs at the credit union over the last three years? Trends seen here provide a longer-term view of loan growth at the credit union, and not just a snapshot of a quarterly or annual result.

5. **Amount of Loans Granted in Last 12 Months** (15%) -- How much in loans did the credit union distribute during the past year? As a major gauge of loan activity, this can provide a key view of current lending trends at the credit union.

6. **Growth in Average Loan Balance per Member** (10%): How are the members using the credit union's consumer lending programs? Increased balances indicate more product usage, and therefore can be a metric of how members are valuing loan products.

Member Service Usage
The final component is Member Service Usage. This component measures how efficiently a credit union provides and promotes services to its members. The leaders in this category are those credit unions that have a high number of core account relationships with their members. The penetration rates are a key metric as to how members value the credit union's product offerings. Is the credit union considered the member's primary financial institution (PFI) or are they having their other financial needs met elsewhere? Moreover, measuring productivity of employees by calculating the amount of revenue generated per dollar of salary and benefit expense helps to capture the staff involvement in member activity. There is a positive correlation between member activity and the amount of income generated per employee since credit unions with a more active membership base are more likely to use the credit union as their PFI and generate more revenue. Individual weights of each component are included here:

1. **Number of Share Draft Accounts / Members** (20%) -- Do members consider the credit union to be the primary financial institution? The PFI is most often defined as the institution the member has their checking account with.

2. **Number of Auto Loan Accounts / Members** (15%) -- Auto lending is traditionally a core expertise of credit unions and accounts for approximately 40% of the average credit unions loan portfolio. Are members using the credit union to finance their auto purchases?

3. **Number of Credit Card Accounts / Members** (15%) -- How much has the credit union penetrated the membership for credit cards? Rates and reward programs generally drive this metric.

4. **Total Loan and Savings Accounts / Members** (15%) -- Does the credit union provide a large variety of savings and lending services that are used by members?

5. **Fee Income / Members** (10%) – What amount of fees does the average member incur at the credit union? High levels of fee income generally decrease member value.

6. **Three-Year Compound Member Growth** (15%) -- Is the credit union bringing in new members? Attractive rates and products are what bring new members in.

7. **$ Total Income/$ Salary and Benefit** (10%): How effective is the credit union staff at generating income from member activity? The higher the ratio, the more effective the credit union is at generating revenue with its current staff level. This often reflects deeper member relationships.

How ROM is Calculated
A value between 1 and 100 is assigned to each credit union, depending on their performance in the three core areas of Return of the Member. The primary credit union's final score is a combination of the weighted average of the percentile ranking for each ratio. Credit unions with a score of 100 are considered leaders in providing services to their members.

Components	Percentile Rank	Weight	Final Score
Return to Savers	100	40%	40
Return to Borrowers	100	35%	35
Member Service Usage	100	25%	25

Total Raw ROM Score: 100

An Example: ABC Credit Union
The first ratio in the savings component of ROM is dividends to income. ABC Credit Union, a $75 million institution, has a dividends-to-income ratio of 40.6%. Rather than use that ratio, we take the percentile rank of this number within ABC's peer group. Below is an example using ABC's Return to the Savers (ROS).

Return to the Savers Calculation
ABC Credit Union

ABC's Values	% Rank in Peer Group		Assigned Weight		Weighted Score
Dividends/Income(40.6%)	**98.1%**	**x**	**30%**	**=**	**29.4**
Avg. Div. Paid (2.0%)	**93.3%**	**x**	**30%**	**=**	**28.0**
Chg in Avg. Share Bal (4.3%)	**63.5%**	**x**	**15%**	**=**	**9.5**
# of Sh. Accts/Mem.(1.6)	**45.4%**	**x**	**10%**	**=**	**4.5**
3-Year Share Growth (12.6%)	**88.0%**	**x**	**15%**	**=**	**13.2**
					84.6

***Raw score of 84.6 equates to percentile rank of 98.23**

The raw score of 84.6 represents ABC Credit Union's weighted score in the first of the three core areas. This weighted score is then ranked as a percentile versus all other peer credit unions for a final ROS score of 98.2. The same kind of calculation is used to determine ABC's scores in the Return to the Borrowers and the Member Service Usage components. The weightings for those can be seen above. After running through similar calculations with those, an example of the total ROM score calculation is now provided.

Total Return of the Member
ABC Credit Union

ABC's Values	Percentile Rank		Assigned Weight		Final Score
Return to Savers	**98.23**	**x**	**40%**	**=**	**39.29**
Return to Borrowers	**66.50**	**x**	**35%**	**=**	**23.28**
Member Service Usage	**77.24**	**x**	**25%**	**=**	**19.31**
					75.58

***Raw score of 75.58 equates to percentile rank of 85.39.**

What does a 75.58 Raw Score Mean?
The raw score of 75.58 represents ABC Credit Union's weighted score for ROM. This raw score is then ranked as a percentile versus all other peer credit unions for a final ROM score of 85.39. ABC Credit Union's ROM score is 85.39 is performing well above average. The average credit union scores around 50 due to the nature of percentile rankings. Therefore, ABC is performing better than 85% of the credit unions in its peer group.

There are still areas for improvement, however. ABC received a 66.5 Return to Borrowers. This may indicate that ABC is offering less competitive loans rates to its members, leading to lower penetration rates. On the other hand, ABC performed much better than its peers in Return to Savers, scoring a 98.23.
The drive for increasing member value is generally to promote growth, leading to the ability to add more products and services while giving more back to the members in the form of better rates. This cycle benefits both the member and the credit union.

Does Higher Member Value Yield Greater CU Performance?
Do credit unions with higher Return of the Member scores perform better than those with lower scores? When analyzing the top performers in Return of the Member, it is safe to assume that the credit unions at the top of the list will be strong performers in the metrics included in the various ROM components. How do they fare when looking at other criteria? The below group was formed using those credit unions with $1 billion plus in assets as of December 31, 2007.

	12-mo. Loan Growth	12-mo. Share Growth	Net Interest Margin	ROA	Operating Exp./ Ave Assets	Delinquency Ratio
Top 10 Percentile	13.80%	13.00%	2.25%	0.92%	1.86%	0.53%
Middle 10 Percentile	8.80%	9.40%	2.59%	0.57%	2.78%	0.87%
Difference	5.00%	3.60%	-0.34%	0.35%	-0.92%	-0.34%
Percentage Difference	43.20%	38.30%	15.10%	38.60%	33.10%	39.10%

Within that asset group, those credit unions that scored in the top ten percentile of ROM were compared to those who were in the 45 to 55 percentile range. For all categories but one, the top credit unions in ROM had a value that was at least one-third better than the mid-range percentile group. Why is the group ranked higher in ROM performing much better in other areas? Providing high member value creates a virtuous cycle of performance as credit unions provide products and services that maximize member welfare, while increasing the probability that members fully utilize the offerings of the financial institution.

Callahan's ROM scoring system was not designed to be the final word on credit union performance. However, it is intended to be an important measure of the economic return created for individual members relative to other credit unions of similar size given currently available public data.