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No Tax? No Thanks…

Canadian Credit Unions Are Taxable AND Successful

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For the scores of credit unions undertaking or contemplating a conversion to a mutual savings bank, federal taxation tends to be the biggest obstacle.

But the tax subsidy that all American credit unions enjoy has been under attack by the banking community for years. And the passage of time, or laws, may erode it or even eliminate it entirely. There's growing political noise in Washington, DC, Alabama, Florida, California, Texas, Iowa, and other states about stripping away non-taxable status from credit unions - at least the larger ones.

Will that mean the death knell for credit unions? It doesn't have to. Certainly, credit union bottom lines are thin, and there's little room to pay new taxes. But when we look for reasons behind our less-than-stellar market share, maybe the tax subsidy is part of the problem. For a different approach, perhaps we should turn our heads north of the border.

The Canadian credit union system, including the caisses populaires in the province of Quebec, serves 11 million people - one-third of the entire population. With $150 billion in assets, credit unions collectively have become the sixth largest financial institution in the country, serving just retail customers and small business. And unlike their U.S. counterparts, which have a broad consumer base but low wallet share, the collective market share of credit unions in Canada ranges as high as 25% in the prairie provinces, to 33% in British Columbia, to a whopping 50%+ in Quebec.

Canadian credit unions have been taxable for many years. And so, unlike credit unions converting to thrifts, they don't think about profitability in terms of having to make up lost ground.

The key to overcoming a taxation hit on the bottom line is not to use the tax subsidy as a crutch in the first place. Don't just play in the shallow end of the pool. U.S. credit unions need to move away from a "cheaper is better" positioning. Unless you're a buying and distribution powerhouse like Wal-Mart, which can keep creating breathing room on the cost side, price is a loser's strategy. It's too easily matched. It erodes profitability, and eventually market share. If you're under-resourced to begin with, low pricing is simply not a sustainable advantage.

The key to success for Canadian credit unions is strategy -- positioning and marketing. They don't compete on price. They don't try to be the place where someone can go for the lowest rate on a car loan or mortgage.

Since most are community bond, they don't have the cost advantages that a lot of U.S. credit unions rely on -- in real estate concessions or communication advantages from their sponsor organization. So they couldn't play low-price leader if they wanted to.

But why would they want to? The kinds of customers attracted by the best prices are often bottom-fishers, who will bail as soon as a better offer comes along.

If you're always talking about price in your marketing, there's also a tendency to draw the lower-income, lower-asset segment of the market. Instead, send messages about service, product knowledge, a sophisticated product suite, advice and relationships. Those are the things that draw the better clients to credit unions, right up to the mass affluent and even high net worth.

According to the Washington, DC-based Council on Financial Competition, here's what banking customers say is important to them: recognition, understanding my needs, advice, and personalized relationships.

If you think about the word "Relationship" in a human sense, you immediately realize the essence of what makes a good one. It's mutuality. That holds true for a husband and wife, or best friends. Each partner has to get something out of the relationship -- in the way of benefits -- in keeping with the effort they put in. Otherwise, if it's too one-sided, then it's not much of a relationship. And ultimately it's doomed.

From a business standpoint, the good news is most of your members do want a relationship with you -- but not if it's just the credit union that benefits.

For consumers, the keys to a relationship are:

- It's always going to be fair
- It responds to my needs
- I'm listened to, AND
- I'm valued.

Canadian credit unions have discovered that it's not so much co-operative values that members care about - it's feeling valued.

There's no question they enjoy profit-generating advantages over their U.S. counterparts, such as a wider ability to offer business lending, mortgages, wealth management and insurance services. And they can grow faster by raising extra capital through the issuance of preference shares to their members - from a few hundred thousand dollars' worth for smaller credit unions to tens of millions of dollars for the big ones.

But with asset growth running at 20% or even 30% a year and ROE in the teens, the leading Canadian credit unions are proving to be scrappy competitors to Canada's biggest banks. They aren't handcuffed by a tax subsidy, or resigned to deliver second-best services to people motivated by co-operative values. They're fighting the banks head-on for the best customers. And many are winning.

It's because they try to be better, instead of cheaper or different.

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