

2005: Scenarios for Credit Unions

An Executive Report



Decision
Strategies
International, Inc.

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This report was written by Doug Randall and Paul J.H. Schoemaker, Ph.D., of Decision Strategies International, with contributions by Franck Schuurmans, Ph.D., of CUES. George Hofheimer, CUES, Roch Parayre, Ph.D., and Michael Mavaddat, both from DSI, developed the statistical data and graphs. The scenario planning methodology developed by Paul Schoemaker and associates forms the foundation of the CUES' CEO Institute program at the University of California-Berkeley where Dr. Schoemaker serves as lead faculty. CUES and DSI offer a wide scope of strategic services ranging from a turnkey strategic planning process to consulting workshops with Dr. Schoemaker and other DSI consultants.

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Dear Credit Union Executive:

Please fasten your seatbelt: *the future promises to be an exciting ride.* And there's no telling where exactly you're headed.

But there are indications—warning signs and guideposts—that can help you steer clear of the dead ends and stay on the fast track. The more accurately you can use these “signs” to envision potential future scenarios, the more adequately you'll be prepared.

You hold in your hands a “roadmap” through four such scenarios: *2005: Scenarios for Credit Unions—An Executive Report*. Developed by Decision Strategies International, Inc. (DSI) and the Credit Union Executives Society, this relevant, real-world resource juxtaposes potential changes in technology and competition to formulate different possible scenarios that will drive future strategic planning dialogue at your credit union. DSI—led by Paul Schoemaker, Ph.D., CUES' CEO Institute I lead faculty—is one of the leading scenario planning consulting firms in the world. Its client list includes AT&T, General Motors, IBM, Lucent Technologies and Paine-Webber.

And we're giving the report to you free.

Why? Because this publication has struck a nerve in the credit union movement, creating a demand for deeper exploration of these scenarios and the strategic-planning process. And it's critical, as new insights evolve, to get all credit unions on the same page. That's why CUES® has partnered with CUNA Mutual Group—who generously agreed to underwrite all printing and mailing expenses—to distribute copies of this report to all U.S. credit unions and CUES-member credit unions worldwide. CUNA Mutual has a tradition of strengthening relationships to help make credit unions the very best retailers of financial services.

2005: Scenarios for Credit Unions is not about predicting the future or prescribing solutions. It's about provoking debate and propelling new lines of thinking. And it's our gift to your credit union as a way of encouraging continual in-depth examinations of the ever-changing environment.

If you are interested in learning more about CUES, contact our membership services department at 800.252.2664 or 608.271.2664, ext. 3400; or visit www.cues.org.

Best regards,



William J. Rissel
CUES Chairman of the Board of Directors

P. S. For a listing of other strategic services from CUES and CUNA Mutual designed to help enhance the future of your credit union, turn to the appendix found in the back of the report.

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2005: Scenarios for Credit Unions— An Executive Report

According to the National Credit Union Administration, approximately 75.5 million credit union members in America are served by roughly 11,100 credit unions. With over \$400 billion in assets, credit unions make up about 8 percent of the nation’s insured savings deposits. These organizations aren’t known for their control over consumers’ assets, but rather for their credit union mission.

What sets credit unions apart from other financial service providers is their distinct philosophy: member-owned, not-for-profit cooperatives, serving the needs of particular groups of people. Interestingly, while the public shows greater trust in credit unions than in banks, and praises credit unions for the respect with which they treat their members, consumers generally are not aware of credit unions’ distinct features. Because of this, as well as other forces, today’s credit unions enter a new and challenging era where they will have to rethink their past mission and redefine their vision for the future.

A Stable History

Credit unions first emerged in central Europe during the final decades of the 19th century. At that time Europe experienced a truly global economic crisis as agricultural imports from the Americas flooded domestic markets, dramatically lowering prices. During the height of this crisis, many farmers in Germany and elsewhere faced the threat of bankruptcy.

Concerned with the plight of ordinary citizens, who were not served by traditional financial institutions, community leaders looked for solutions by pooling the scarce resources

available in their community. Neighbors joined forces and placed their savings in the hands of trusted individuals who made short-term, small loans to trustworthy individuals in the community. Inadvertently, the early visionaries of the credit union movement were also creating a new line of financial products: consumer loans.

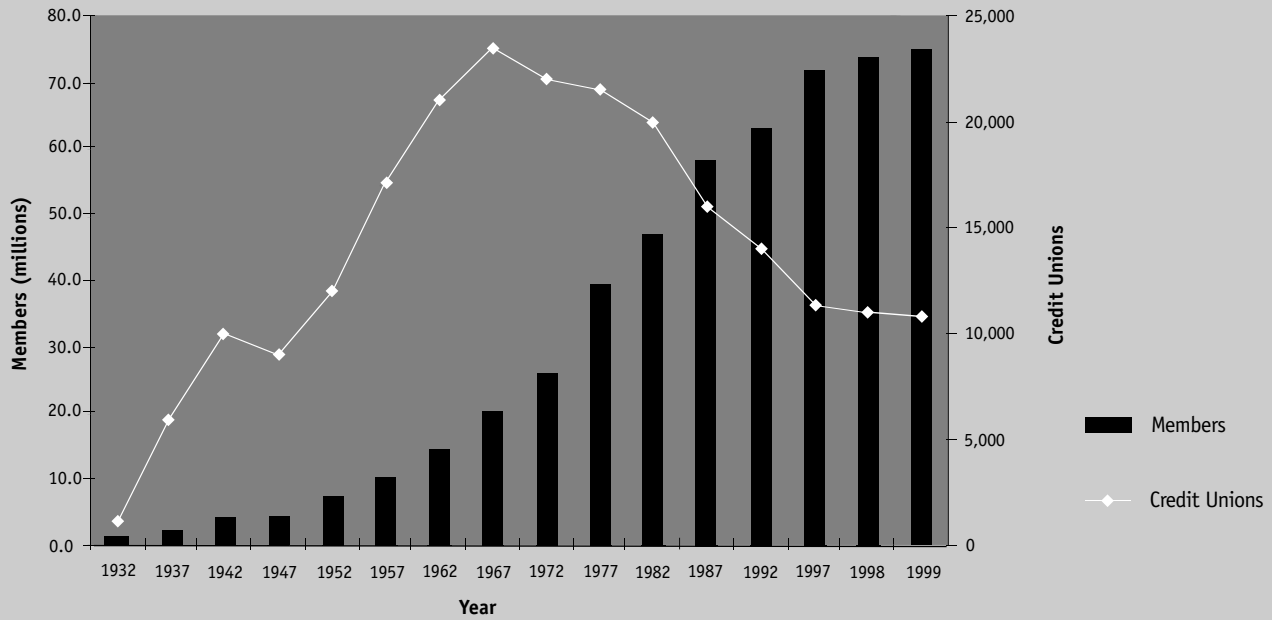
Although many people played leading roles in the development of the cooperative bank system in Europe, this movement was by and large a local, spontaneous and unregulated initiative. In the words of author Dr. Margaret Wheatley, “Credit unions started as self-organizing organizations during a time of crises.”¹ In the language of the credit union movement, this sentiment is best expressed in the slogan “people helping people.” This focus on members rather than the bottom line remains a fundamental value for many credit unions, although not all.

The credit union concept took hold much later in the USA, via the Credit Union Act of 1934, which was greatly inspired by Roy Bergengren and Edward Filene. At that time, the guiding principles of credit unions were to serve members with loans for “prudent and productive” purposes based on individuals’ desire to repay, and not necessarily on credit history, ability to repay or other financial criteria.

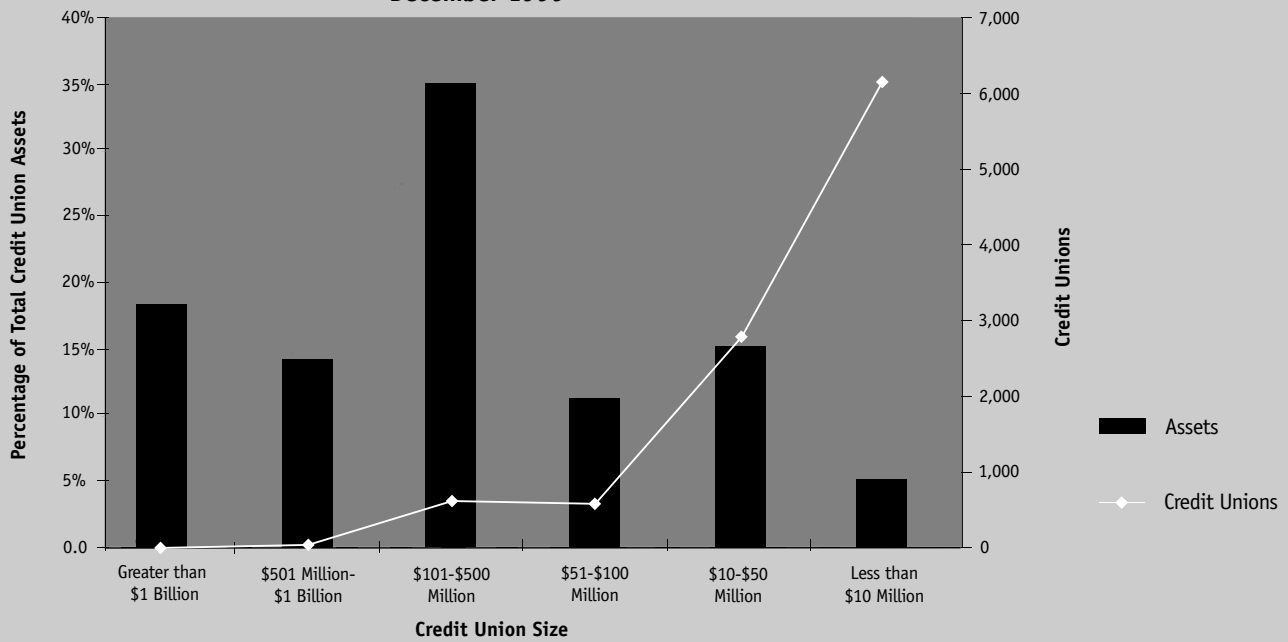
As before in Europe, this cooperative-based mission worked because credit unions were built by community members who knew and trusted each other. Corporate sponsors offered credit union membership as a benefit to their workers, and this sponsor relationship in turn enhanced the viability of the institution. In cases where the field of membership was defined by a single corporate sponsor, the employer could withhold wages as a form of collateral. Thus, credit unions grew and flourished as closed financial systems, borrowing and lending from only those within the credit union family, in order to serve the group’s collective interests.

¹ Credit Union Executives Society, CEO Network, Palm Beach, Fla. 1996

Total Number of Credit Unions and Members, 1932 - Present



Size Distribution of Credit Unions December 1999



To this date, the credit union movement's mission remains largely intact. Despite the changing environment around them, most credit unions have continued to operate in much the same way as Bergengren and Filene envisioned at the turn of the century. This resilience amid change is a testament to the strength of the vision, the robustness of the institutional model of credit unions, and perhaps to the continuing needs of the under-served in the community and marketplace. Credit unions continue to provide consumers in the financial services market with an important choice. But will this last?

A Time for Renewal?

Despite the credit union movement's stable history, business history teaches us that past success is no guarantee of future survival. No industry can rest on its laurels, especially when the world around it is changing. Credit unions should continually scan the external environment to understand how the dynamics are shifting—and what the implications may be for their particular institution. To understand why this scrutiny is so crucial, consider the well-known demise of the buggy whip industry circa 1893, and why it has become a classic example of failure to adapt.

Buggy whip production was growing rapidly in the early 1800s, just as the credit union industry would a century later. Anticipating a dramatic jump in demand for private transportation, buggy whip producers expanded their operations. The industry's players shifted from small one-family shops to large national companies. However, by 1893, the market for buggy whips had changed drastically. Former customers were leaving their horses and buggies for a more efficient transportation vehicle—the motor car. The market for buggy whips withered away and so did most buggy whip manufacturers.

How might it have turned out differently? In developing their strategies in the mid-1800s, buggy whip manufacturers could have considered the bigger picture. They should have realized they were not merely buggy whip manufacturers, but that they were in the business of personal transportation. Perhaps then, they would have transformed their plants from buggy whip manufacturing operations to something more

closely connected to the automobile. At least they would have realized that the demand for buggy whips was soon going to decline as alternative transportation choices were introduced.

We chose buggy whips as an illustration because it is a well-known case in which a long-standing industry became extinct due to a narrow framing of the options and lack of forward-looking leadership. We should heed the lessons of history to avoid making the same mistakes.

A similar fate befell the manufacturers of sailing ships when confronted with steam engines and the producers of mechanical excavation equipment in the face of hydraulic technology. Most vacuum tube producers did not survive the evolution to transistors and electronics, and many transistor manufacturers failed to capitalize on the promise of integrated circuitry. More recently, the Encyclopedia Britannica ignored to its peril predictable developments in CD-ROM technology, resulting in a 50 percent drop in revenue from 1990 to 1995 alone.

The history of business suggests that winners can quickly become losers. The reasons appear numerous: overconfidence in the current business model, filtering and rationalization of signals that don't fit, lack of vision and leadership, listening to the wrong customers, incentives to maintain the status quo, and the collective reinforcement of like-minded souls populating the same industry.

Strategic planning could have helped many formerly great companies think about the future and devise a plan that might have helped prevent their demise. Some organizations, such as DuPont, Kodak, Mitsui and Unilever, have survived over 100 years. What sets them apart is their focus on the external environment—that is, they study and interpret the forces of change—and their willingness to change.²

Often, it was a deep crisis that prompted the change, as in the case of the Encyclopedia Britannica and CD-ROM technology. However, a crisis is an expensive way to adapt and sometimes it is too late. Instead, leaders should explore crises before they happen. Scenario planning can be viewed as the creation of surrogate crises that should engender the same zest for change as real crises would.

²Arie de Geus, *The Living Company*, Harvard Business School Press, 1997

Also, as leaders well know, a crisis is often an opportunity in disguise. Interestingly, the Chinese characters for crisis are the same as those for opportunity and both denote change! Great leaders create crises (simulated or real) to foster change.

Since the mid 1970s the financial services industry has seen fundamental changes in its industry dynamics, just as buggy whip manufacturers and so many other organizations and industries have in the past—and will in the future. The industry has migrated from one where business was conducted leisurely over lunch and cocktails to an industry of intense global competition. We list below some of the forces that have changed the financial services industry, over the past few decades, based on an analysis by Chris Marshall and Richard Nolan of the Harvard Business School.

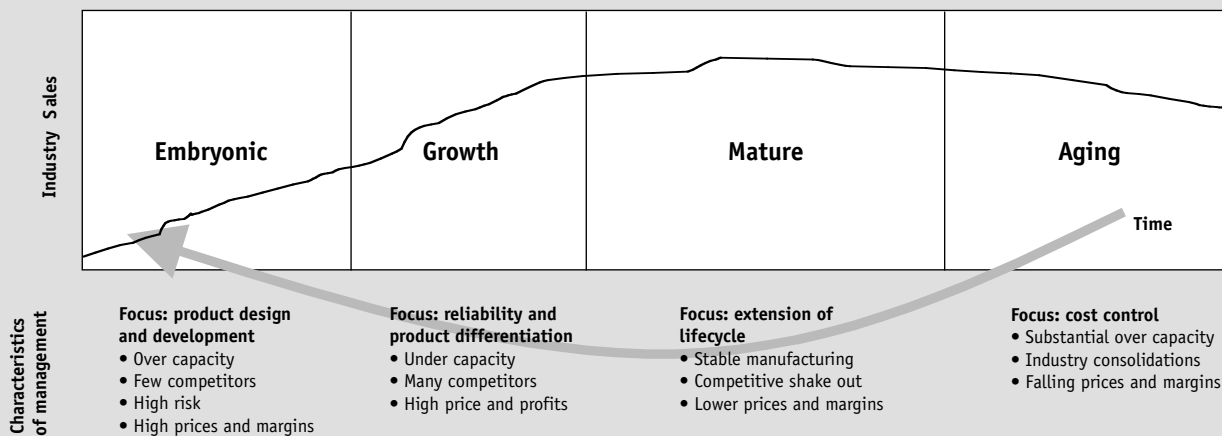
- 1) stricter standards for pension funds, forcing greater diversification of portfolios and the use of new technologies;
- 2) mounting pressure on trading and settlement systems from global offshore markets;
- 3) abolition of fixed brokerage commissions, which gave rise to discount brokers;
- 4) increases in the volatility of commodity prices, exchange rates and interest rates;

- 5) introduction of numerous new financial products and services (over 200);
- 6) increasing globalization of financial markets due to deregulation and technology;
- 7) breakdown of barriers between long-term bond markets, money markets and the stock markets due to deregulation;
- 8) increase in the number of mergers and acquisitions as the industry consolidates; and
- 9) vast increase in the number of alliances and outsourcing deals.

These and other forces have been prevalent in the financial services industry for years—and are changing the strategies financial services companies pursue. When these forces are coupled with the changing technological environment and more specific credit union forces, the future playing field seems more and more uncertain for credit unions.

We believe the credit union industry is facing a critical time—one of industry renewal. It has moved through the stages of birth, growth and maturation, and now faces either decline or rebirth, depending on actions yet to be taken by the industry's leaders. Figure 1 illustrates the typical life cycle of an industry, highlighting the different challenges senior managers face at each stage of the industry's evolution.

figure 1



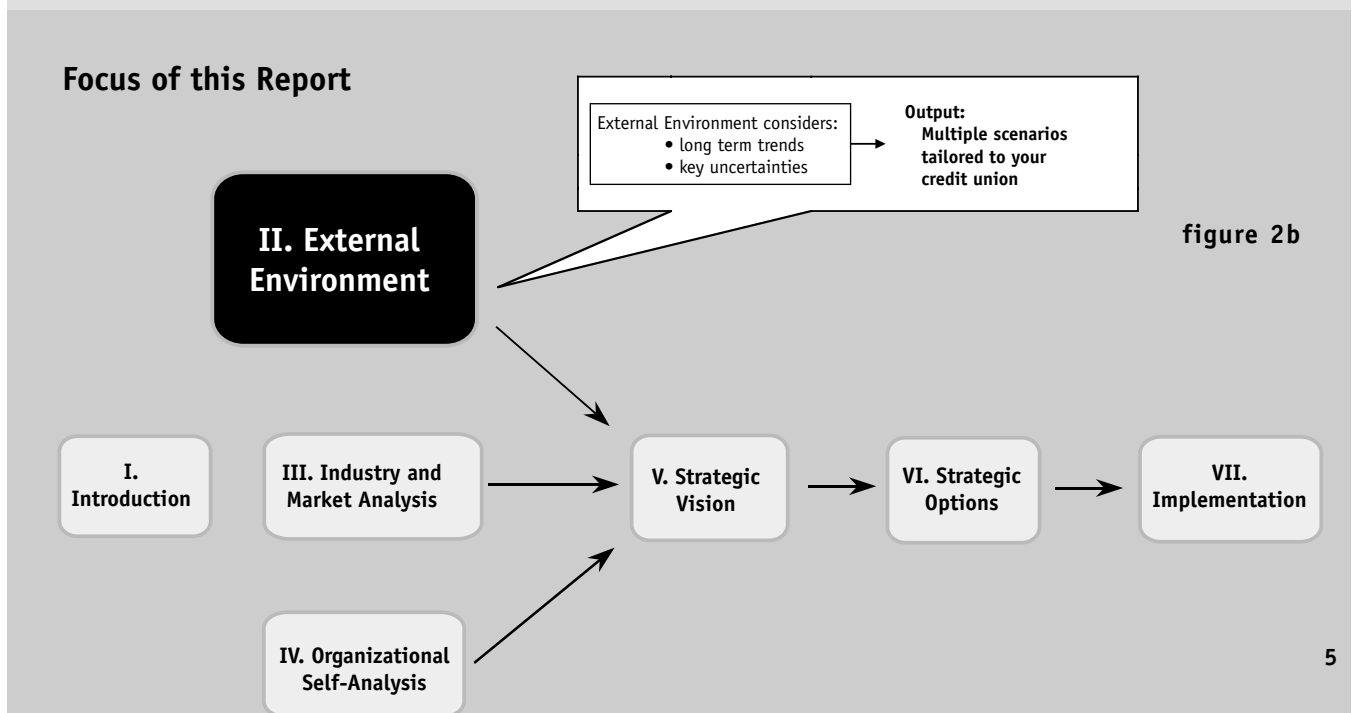
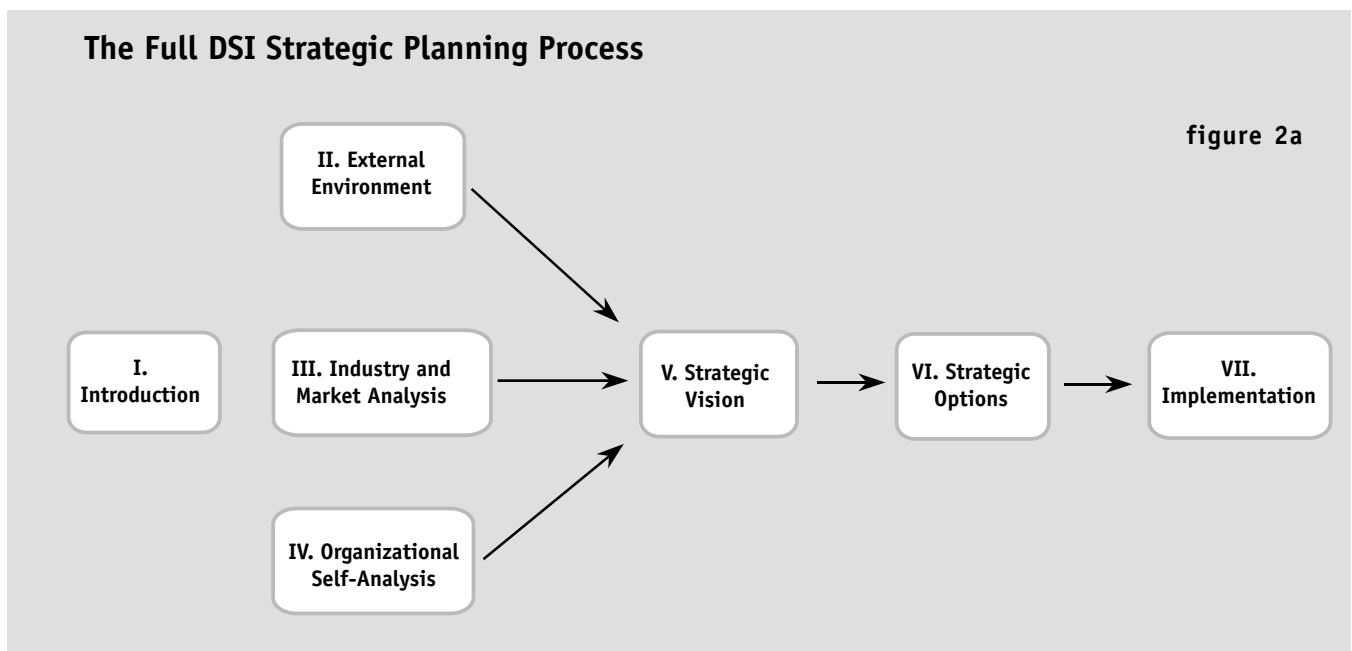
Source: Michael Porter, *Competitive Strategy*, FreePress, 1980

Using Scenarios to Rethink the Industry

Scenario development is a strategic planning process most commonly used by organizations facing highly uncertain futures. *Whereas traditional planning focuses on forecasts and the extrapolation of current market conditions, scenario planning focuses on future possibilities.* While traditional planning emphasizes the trends and issues of fact about the future, scenario planning explores the unknowns and vagaries of the future. And where traditional planning tries to define what the future will be and advises managers to build plans to meet that view, scenario planning imagines

what the future could be and how managers can build strategies to shape it.

Scenario analysis is a creative way to explore the forces acting on your organization. Scenario development constitutes the first few steps in Decision Strategies International's seven-phase strategic planning process (see Fig. 2a and 2b). This industry scenario report is restricted to phases I and II of the full DSI process.



Three fundamental premises underlie DSI's scenario planning process:

- a) The first is a commitment to what we call disciplined imagination. We believe that in thinking about the future, executives should be creative and innovative but also follow a well-defined process for embracing the uncertainties that lie ahead.
- b) The next underlying belief is that numerous uncontrollable forces act on organizations. We should identify these forces' potential outcomes and explore their interactions rather than vainly trying to develop strategies for affecting these external forces.
- c) One final premise is that strategy is best developed by those responsible for executing it—not by outside experts alone nor by an executive team without input from others. But, again, a disciplined process is needed to untangle the many complex and thorny issues facing the organization, as well as to manage the internal politics.

The seven-phase process diagrammed on the previous page, which begins with an in-depth review of the external challenges, is built on these and other premises. In phase one, called introduction, the organization reviews its past performance and the special challenges of becoming more strategic. In phase two, the organization examines the external environment and develops industry scenarios.

The third phase focuses on strategic segmentation. In this phase, managers and directors divide the industry playing field and analyze the segments to determine in which areas the organization could compete. The fourth phase is devoted to an internal analysis to identify the company's core competencies, those things they are particularly good at doing today.

The fifth, or vision, phase is where decisions about future direction are made. Building on the previous phases, managers and directors outline a high-level description of what the company will do and some fundamental points about how to make it happen. The sixth phase, strategic options, is where the vision is defined more specifically and priorities are established. Here is where executives and board members identify possible projects and action plans that are consistent with the vision and prioritize them.

The final phase concerns execution, where the work of the previous phases comes to full fruition. In this phase, resources are allocated, objectives are met and the vision is carried out.

Different organizations emphasize different parts of the seven-phase process depending on their strategic planning experience, interest level, challenges faced and commitment. However, we believe it's important for organizations to commit at least some time to each phase of this general process.

This report is intended to facilitate development of industry scenarios by providing you with a detailed projection of four different futures the credit union industry may experience by the year 2005. We focus on phase two and the beginning of phase three of the process outlined in Figures 2a and 2b. By starting the planning process this way, we hope that credit union leaders will come to terms with the fundamental strategic issues facing them, rather than focusing only on tactical or operational issues. Our aim is to stimulate a strategic dialog within your credit union about your own future.

Specifically, this report includes:

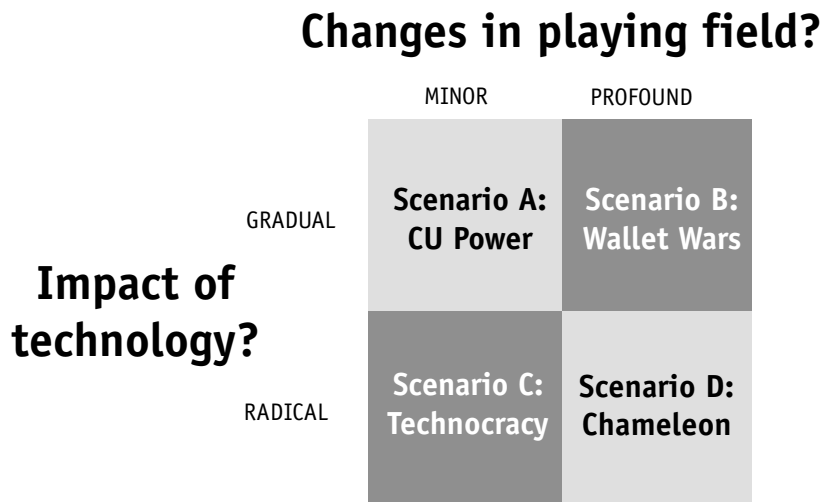
- four scenarios: concrete descriptions of what the world may look like in the year 2005,
- key themes: central messages and implications for each scenario,
- scenario drivers: explanations of the events that “must” occur for the scenarios to emerge,
- sidebars: details on the scenario planning process and results of surveys conducted as part of the process
- appendices describing the process and survey results, and
- related graphics, industry statistics and illustrations.

As you review the scenarios, consider the opportunities they present for reinventing your own organization in light of the changes occurring in the external environment.

The following scenarios—called **Credit Union Power**, **Wallet Wars**, **Technocracy** and **Chameleon**—were created to help you generate strategic initiatives that work for your organization. They depict four quite different views of credit unions in 2005, organized around two main factors—the impact of technology and the emergence of new players. The next page depicts the structure underlying the scenarios.

Chameleon, for example, describes a world in which both the competitive playing field and technology undergo radical change, while **Wallet Wars** is an environment of intense competition, but milder technological change. In contrast, in **Technocracy**, the radical changes are in technology, whereas, in **Credit Union Power**, credit unions encounter only minor change on either front.

The Deeper Structure of the Scenarios



Playing Field Dimension includes:	The Technology Dimension includes:
<ul style="list-style-type: none"> • RULES OF PLAY: laws and regulations • REFEREES: federal, state, courts, etc. • PLAYERS: traditional and new competitors • GAME PLANS: new strategies and tactics • STAKES: what are we competing for? • SPECTATORS: society, sponsors, media 	<ul style="list-style-type: none"> • Internet banking and e-commerce • Websites, portals and interfaces • Check imaging and processing • User verification and smart cards • Database design and data collection • Back-end systems for operations • Advances in software and data mining

Making the Most of Scenario Planning

Most organizations find scenarios effective when they use them as a part of an integrated strategic planning process. Regardless of how they're used, one of the primary benefits of scenarios is learning and provoking creative and innovative thought among managers. Think through the following strategic questions as you consider the scenarios:

- How likely is it that each scenario will occur, and how much impact would it have?
- How will successful credit unions and other financial services companies deal with each scenario?
- How prepared is your organization for each scenario?
- Which important stakeholders will try to affect the scenarios and how?
- Next, you might identify the key success factors for each scenario. In doing so, you'll need to assess what it takes for a leading organization (you or your competition) to be successful in each scenario. After analyzing the key success factors, as well as the likelihood and importance of each scenario for your company, you can weigh the key success factors and rank priorities of future needs for a successful organization.

The art of developing a strategy comes in making the trade-offs between what you're good at today and which of these future key success factors you will embrace down the road. In addition to the scenario analysis, the right blend between focusing on today's strengths and tomorrow's needs depends on your credit union's particular goals and culture.

For more information and concrete guidance on using scenarios in your organization, you may wish to reference the following publications:

Fahey, L., & R. Randall, *Learning From the Future*, John Wiley & Sons, 1998.

Ringland, G., *Scenario Planning*, Wiley, 1988.

Schoemaker, P.J.H., and C.A.J.M. van der Heijden, "Integrating Scenarios into Strategic Planning at Royal Dutch/Shell," *Planning Review*, Vol. 20(3), 1992, pp. 41-46.

Schwartz, P., *The Art of the Long View*, Doubleday Currency, 1991.

Key Terms

Snapshot – A description of the credit union environment written as though it is 2005. These descriptions depict the outside world your organization may face in 2005.

Drivers – A set of forces whose occurrence will cause a particular snapshot to unfold. Drivers can be tracked over time to see which scenario might emerge.

Scenario – The combination of a snapshot and a set of drivers. Scenarios are not forecasts for the future, but tools for experimenting with alternative strategies.

Themes – Common topics addressed in each scenario to highlight its relevance and implications, e.g. regarding member behavior, industry structure, regulation, etc.

Force – A concrete issue or development that may influence credit unions in the future.

Trend – A highly important and highly predictable force. Trends are the "knowns" for the future, such as the aging US population.

Uncertainty – A highly important and unpredictable force, such as the future health of the economy. With their multiple outcomes, uncertainties are the foundation for scenario development.

Scenario A

Credit Union Power 2005: The Snapshot

Both technology and the playing field have changed at a moderate pace, making this the most stable scenario depicted in this report. Even with moderate change in these areas, however, the changing basis of competition, new business models, human resource challenges and industry dynamics are different enough to pose significant challenges for many financial services companies.

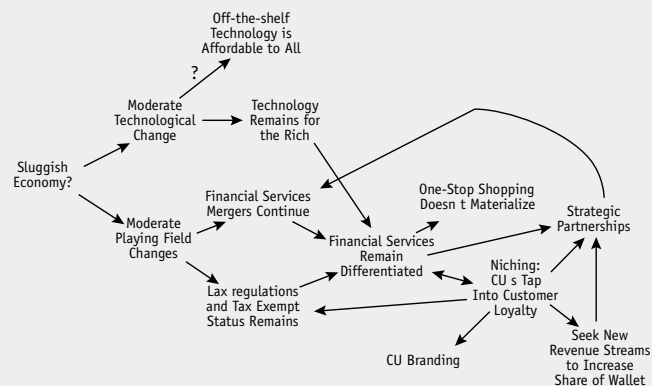
Key Themes: Highlights of Scenario A

- Minor changes in technology and credit union landscape
- Credit union lobby strengthens
- Shrinking—but loyal—membership continues to value credit unions
- Inconsequential new regulations regarding field of membership and taxation
- Minor changes in the basis of competition

Member Behavior:

Consumers have choices when it comes to deciding which financial services company to use. No single choice is perfect. Credit unions are known for their competitive rates and attentive member service but score less well on the convenience scale. They are considered less sophisticated when it comes to mortgages, small business loans, investments, insurance and electronic delivery channels—even though some credit unions offer these services via their CUSO or in partnership with other providers. Banks are good at what they do but generally are considered impersonal and often untrustworthy. Brokerage houses have so many restrictions that they can't really offer the range of services consumers demand.

CU Power Scenario



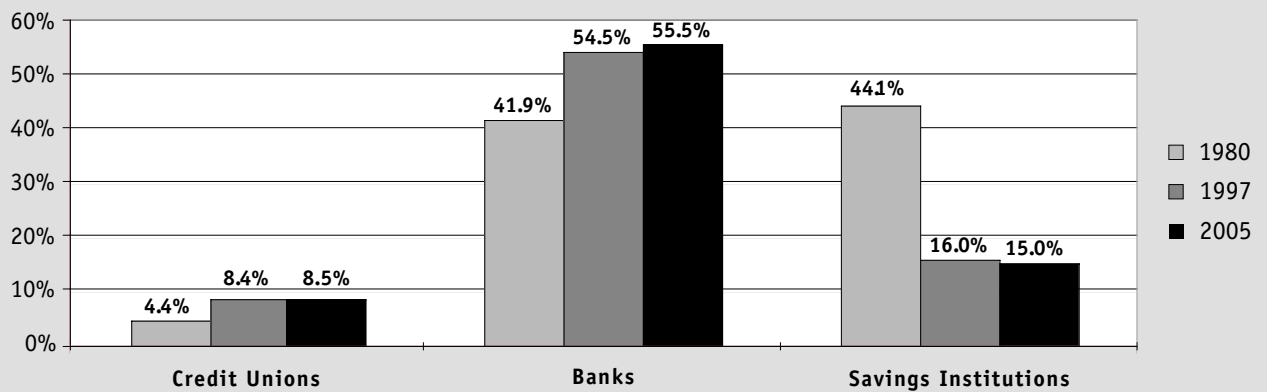
In this world, being a savvy consumer is challenging, and most people choose to maintain relationships with multiple financial services organizations. Managing these relationships, though, is getting increasingly cumbersome and frustrating for some consumers. A significant segment of the membership remains very loyal to credit unions. Some are loyal because of their strong belief in the credit union mission; others, because of competitive pricing. Still others are loyal because they consider credit unions to be at the core of a specific field of membership—either vocational or geographic—and they value these relationships highly. Regardless, credit unions work hard to capitalize on this loyalty and build their brands around it. In general, consumer needs and behaviors have not changed dramatically since the late 1990s.

Industry Structure

In this scenario the industry structure is hard to figure out—especially for consumers—because of the increasingly competitive environment. Mega-finance companies compete face to face with community banks and credit unions. And all are striving to get a bigger piece of the consumer's asset base, while each competes in its own distinctive way.

Interestingly, credit unions have begun to focus on specific niches. Rather than trying to be all things to all people—and diversifying fields of membership even more than today—credit unions are now narrowing their offerings and targeting them to the unique needs of their most central fields of

Market Share of Insured US Savings in Credit Union Power Scenario



Source: CUNA.

Note: The figures for 2005 are a subjective projection aimed at illustrating the scenario rather than a precise forecast.

membership. This “nichification” among credit unions and community banks has allowed them to compete effectively with the mega-companies within specific population segments. At the same time, the mega-companies tend to offer broader services, many of which are technology enabled.

In this scenario, few changes take place in the regulatory environment. Despite extensive lobbying campaigns by bank trade associations, credit unions still enjoy their original tax-exempt status. Already lax field-of-membership restrictions have been relaxed even more despite bankers’ protests. While the threat of a more oppressive regulatory environment remains, most credit union executives feel the war has been won here. Because credit unions tend—for business, not regulatory, reasons—to focus on narrow fields of membership, regulatory agencies are less concerned about credit unions’ special treatment than they would otherwise have been.

Technology

In this scenario, financial services have become more high-tech than during the late 1990s. Internet use has continued to flourish and new delivery channels continue to be introduced. However, technology is by no means the primary basis of competition. Even though most credit unions and banks offer Internet transactions and telephone banking, the number of customers demanding advanced bells and whistles is minimal.

The moderate impact of technology in this scenario is primarily due to infrastructure development challenges and consumer fears about security and reliability. Encryption solutions offered by such companies as Intertrust and IBM have been slow to catch on with most consumers. And, out-of-the-box technology solutions work fine for most organizations, such that expensive systems integration projects are no longer necessary to launch state-of-the-art delivery channels. Hence, many firms offer similar services using similar technologies. Bricks and mortar are less important than they were before the Internet era and the introduction of the ATM, but they’re still essential. Many analysts talk about virtual financial services institutions, but few organizations have accomplished that lofty goal.

Credit Unions

In this scenario for 2005, most credit unions’ products and services look much like they did in the 1990s. The biggest difference is that credit unions are much more aggressive in branding themselves and their offerings. Investment services, which are offered through strategic partnerships, are co-branded and often co-marketed. The credit union brand still means a lot to most credit union members. In some cases, credit unions are leveraging their brand identities outside of financial services by sponsoring community events and promoting products that members might be interested in purchasing (for a fee), just as Citibank did with its CitiTravel service in the late 1990s.

Credit union management continues to face the marketing dilemma of whether the organization should focus broadly to gain mass appeal or narrowly to gain long-term loyalty. This dilemma becomes more pronounced as credit unions deepen their market knowledge about members and non-members. Managers also continue to struggle with new ways to increase revenue while maintaining a superior value proposition to their members. In general, service-based fees are the most promising source for new revenue.

Key Drivers

Taxes: much ado about nothing

During the 1990s, many executives were concerned about the impending threat of taxation for credit unions. As credit unions expanded their scope and size, the banking lobby seemed to get stronger and stronger—both because of their increasing clout and the increasing threat that credit unions posed to them. Most credit union executives feared burdensome taxation legislation for three key reasons:

1. Taxation would reduce return on assets by roughly 50 percent.
2. Capital-to-assets ratios would fall dramatically (they fell from 10 percent to 1 percent for some Canadian credit unions when they became taxed).
3. Product pricing would be at parity with banks.

A few executives, however, believed that even if taxation were to occur, it would not dramatically change credit union economics. Another possibility is that the Senate Banking Committee would exempt banks and credit unions under \$100 million from the Community Reinvestment Act, taxation and other legislation that threatened the demise of smaller financial institutions, particularly in light of the ongoing consolidation of the industry.

In this scenario, these concerns about taxation are not relevant. While the threat of taxation still exists, there's been no

substantial action. Just as HR 1151 had a positive outcome for many credit unions, lawmakers continue to pass favorable (and very little unfavorable) legislation for credit unions.

Technology is sluggish

In the late 1990s Internet stock prices rose to dizzying heights. The investment fervor was exhilarating and offered wild opportunities for innovative technologists. But even then, some investors believed these valuations were not sustainable. Unprofitable business models, inexperienced management teams and rash decision making could lead to a slowing of the information technology pace.

In this scenario of credit union power, technology moves at a moderate pace. While new delivery channels, such as Internet and PC banking continue to grow, they're not in demand as much as most analysts were predicting five years earlier.

Branding and niches allow for differentiation

As competitive pressure mounts and their membership bases become more fragmented, organizations that appeal to targeted groups of individuals are likely to be more successful. Product differentiation has led to whole new product categories in a variety of industries. For example, in the 1980s when Reebok began selling different sneakers for different purposes, such as aerobics, walking, tennis, and even weight training, it became apparent that different people have different needs—and those companies who meet individual needs best are most likely to succeed.

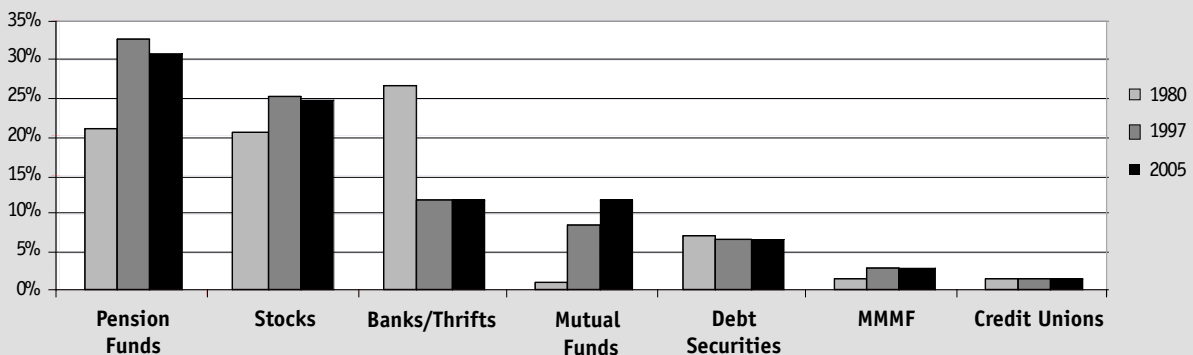
In this scenario, credit unions capitalize on their strengths—primarily a loyal membership base and a distinct identity—by offering products that meet the particular needs of the individual markets they serve. In the late 1990s, USAA, a leading insurance company, focused its products, services and customer service practices on military personnel. This scenario depicts a world where credit unions follow similar strategies, targeting the needs of the restricted fields of

membership they serve. Credit unions know these target segments better than anyone else.

New revenue streams explored

Ask any financial services industry analyst of the 1990s what brings value to the industry, and they would say, “fee-based services.” These services include investment advice, financial planning, trust services, stocks and mutual fund trading, access to on-line delivery channels and ATM networks, and countless other offerings. The key is that financial services organizations reap rewards in ways other than interest from loans, the traditional credit union source of revenue.

Financial Assets of US Households in Credit Union Power Scenario



Source: Filene Research Institute

Note: The figures for 2005 are a subjective projection aimed at illustrating the scenario rather than a precise forecast.

In this scenario, credit unions, like other financial services organizations, focus on new sources of revenue. Some credit unions might even go further by considering selling computers or other expensive household devices, either directly or through kiosks in their branches. In such a situation, credit unions would enjoy a referral fee for each sale and have the opportunity to finance the acquisition as well.

Scenario B

Wallet Wars 2005: The Snapshot

Prompted by free-market economics, the playing field is changing radically, allowing credit unions and other financial services institutions to compete more intensely. At the same time, technical innovations have not developed as quickly as many analysts predicted.

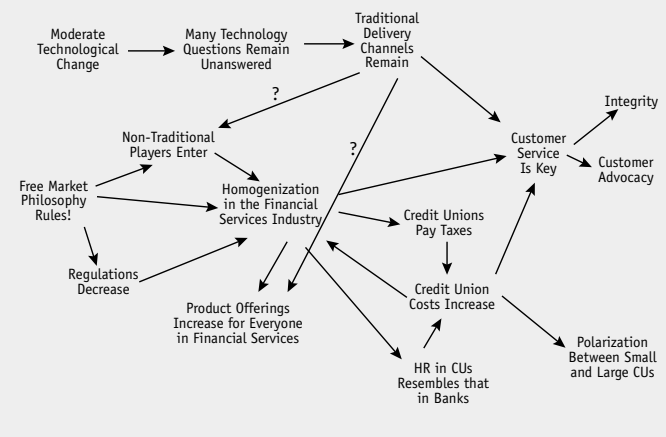
Key Themes: Highlights of Scenario B

- Minor changes in technology and radical changes in landscape
- Increasing fight for share of wallet among banks, mutual fund companies and other financial services
- Credit unions are taxed, decreasing price advantage
- Employee retention becomes more difficult
- Small credit unions are folding or merging

Member Behavior:

In one sense, consumers are overwhelmed by choice. In another they're pleased with the opportunities—a full range of products and services—that individual financial services organizations offer them. Much as supermarkets supplanted the need to visit different stores to purchase fruits, dairy products and groceries decades ago, mega-financial services institutions are eager to manage all of a consumer's financial assets today. Credit unions, banks, brokerage houses, mutual fund companies and insurance companies are all trying to increase their share of consumers' wallets—and they're aggressively encroaching on each other's turf. Each sector of the industry is trying to extend its products and services into new realms, in the hope of increasing the total amount of money it manages, controls and influences for each customer.

Wallet Wars Scenario



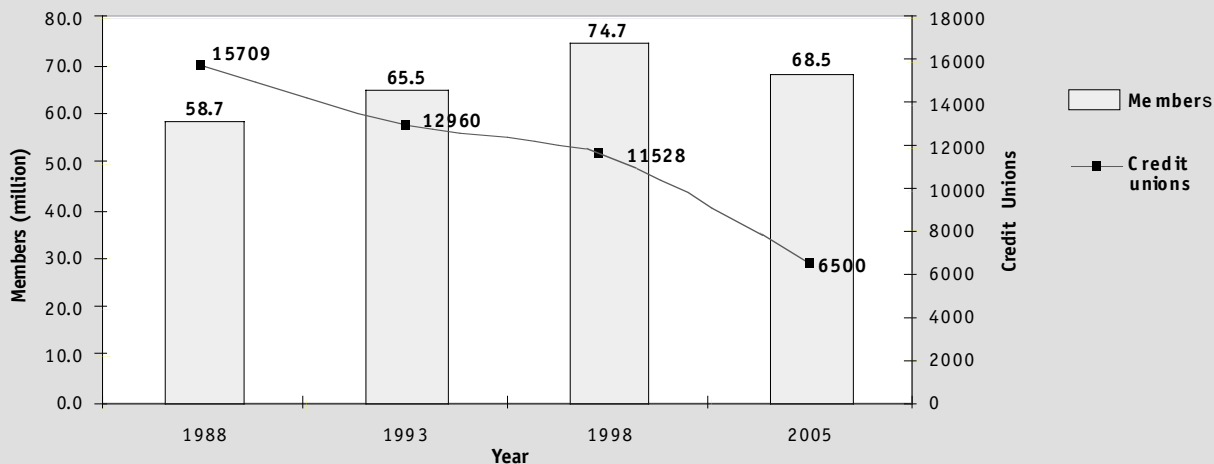
Banks are successful in cross-selling brokerage products with standard savings and checking accounts. At the same time, brokerage houses are offering “full-service” accounts that include free checking and ATM usage, making them an attractive option to consumers. As institutions aim to become “universal financial service providers,” consumers are benefiting from increased flexibility, more options and truly competitive prices, all as a result of the increasing competition among financial services organizations.

Industry Structure

Imagine a future where the playing field for credit unions and their competitors has leveled in numerous ways. Sweeping regulations passed against credit unions in 2002 ended the preferred tax status formerly enjoyed by credit unions; now they must pay corporate taxes equivalent to those paid by banks. At the same time, onerous field of membership limitations have been relaxed even more dramatically since the passing of HR 1151 in 1998. In this scenario, credit unions can serve virtually any financial service consumer. A loosened regulatory environment has also led to substantial relaxation of restrictions on product offerings, allowing all financial services companies to delve into new product lines, such as insurance and securities, in order to expand their share of the consumer's wallet.

As these barriers among financial services companies broke down, the bases of competition changed dramatically. As it

Total Credit Unions and Members in Wallet Wars Scenario



Source: CUNA

Note: The figures for 2005 are a subjective projection aimed at illustrating the scenario rather than a precise forecast.

has always been, price (loan rates, service charges, access fees, etc.) remains important. But in today's competitive marketplace, customer service has taken on a new level of demand. The impersonal style of many banks has prompted customer migration to more friendly options. Service means more than it used to. Indeed, high-touch service is important, but so is the ability to help consumers manage their assets efficiently, comprehensively, and proficiently.

As a result, consumers prefer financial services organizations that have integrity, an asset many believe has been resident in the credit union movement since its foundation. Credit unions continue to market their "consumer advocacy" approach, which shines through even more today than it has in the past. In addition, credit unions try to leverage the relationship with their customers by making their contact a more pleasant experience. "Fun" becomes a key ingredient in attracting members and eliminating the drudgery of conducting one's financial business.

Technology

In this imagined new world, the biggest surprise is the minimal impact that new technology has had on financial services companies. While the Internet continues to grow rapidly, it has not revolutionized the global economy, as so many late 20th century analysts confidently and wrongly predicted. Delivery channels continue to be updated by technology innovations but, like the Internet, a lot of the promises have turned out to be more about hype than

about new ways of doing business. Technology offered more sizzle than steak in this world.

While the number of banks conducting business on-line has increased at a rate of roughly 5 percent per year since 1999, this has not substantively changed the way financial transactions get done; branches, ATMs and call centers remain the primary delivery channels. Not surprisingly, people are still talking about how important Internet banking will be in the next 5 to 10 years, but the shrewdest forecasters are not commenting on future delivery channels because so many questions still loom: Which channels will consumers demand? How will they be priced? Will bandwidth increase to sustain mainstream communication on the Internet? What security measures will be implemented?

In some corners of the market, we see a consumer backlash against technology, which threatens to invade people's homes and lives in ways that are deemed a threat to privacy. Some people long for the simpler good-old days. The well-recognized trust consumers have in credit unions, combined with the appreciation consumers have for respectful treatment improve credit unions' position vs. their competition.

Credit Unions

The rapidly changing environment has led to fundamental culture shifts for most credit unions. In their expanded role as full-service financial providers, credit unions have adopted

some of the human resources practices of other financial services organizations. With more crossover among financial services companies, credit union management salaries have increased by 30 percent, adjusted for inflation. Similarly, performance-based bonus programs are commonplace. Training programs are on the rise, and it's much more common for credit union executives to have MBAs or related finance degrees than was the case in the late 1990s.

These culture changes were embarked upon to retain and attract key credit union employees, and credit unions have had some success in accomplishing this goal. Furthermore, many credit unions now operate in a team mode and increasingly resemble the “flat organization” business model. In this world, credit unions are less hierarchical, and not managed in the traditional top-down mode, but rather on a peer-to-peer basis. Greater autonomy at the base gives credit unions the agility that benefits a smaller organization.

Credit unions are focusing more intensely on profitability. New tax laws have increased overhead, a troublesome burden for some credit unions.

In this scenario, the gap between larger (over \$400 million in assets) and smaller (less than \$50 million in assets) credit unions has widened. Due to revised regulations and changes in member needs, larger credit unions look much more like banks and brokerage houses than they look like smaller credit unions. Larger CUs' compensation programs, management team practices and product offerings compete ferociously with banks and brokerage houses. Smaller credit unions, on the other hand, are struggling to survive in small friendly niches that are shrinking and where competition is on the rise. Those based with corporate sponsors tend to be more successful, chiefly because of their community roots. Increasingly, however, these smaller credit unions are closing, merging or changing their charter.

Key Drivers

Taxes are imposed

One of the biggest signs of the changing environment for credit unions comes from the regulatory realm. The lobbying efforts of banks have posed a threat to credit unions for years, as seen during the HR 1151 debates. As this tension mounted in the late 1990s, credit union executives often wondered: What will happen if we're taxed? Most executives considered taxation, or an even playing field of any kind, to be a threat, but others contended that it might enhance credit unions' stature with the American public.

This scenario paints a world where credit unions are indeed taxed. However, with taxation comes parity of other types. For example, field of membership restrictions are lifted, making credit union charters look much more like those community banks. Similarly, the range of services credit unions are allowed to offer has also broadened, increasing revenue opportunities. In this scenario, boards of directors may be compensated for their contributions to the credit union. Interestingly, the scenario also postulates changes in the bases of competition so that price is less important, while service and innovation become paramount. This shift bodes well for many credit unions who already pride themselves on outstanding customer service. Innovation proves to be a more difficult challenge.

Wallet wars accelerate

The long-time battle for an increasing share of consumers' wallets continues to play itself out in the financial services arena. Brokerage services want to offer banking, banks want to sell stocks and credit unions wish to sell insurance. With an even playing field, all of this—and more—becomes possible. Regulators allow financial services companies to provide a wider range of offerings. Consumers are thrilled with the greater convenience of one-stop shopping for financial services.

In this scenario, wallet wars are fierce and increasingly global. All financial services organizations have a mandate to compete with each other. The result is bitter rivalry. In some markets, we see loss leaders where sell services below cost to gain market share. Amazon.com has experienced great success in its on-line bookstore using this strategy. This highly fragmented competitive climate is likely to lead to industry consolidation over time—both within classes of financial services companies and among them—but the scenario depicts a world where that consolidation has not yet fully taken place.

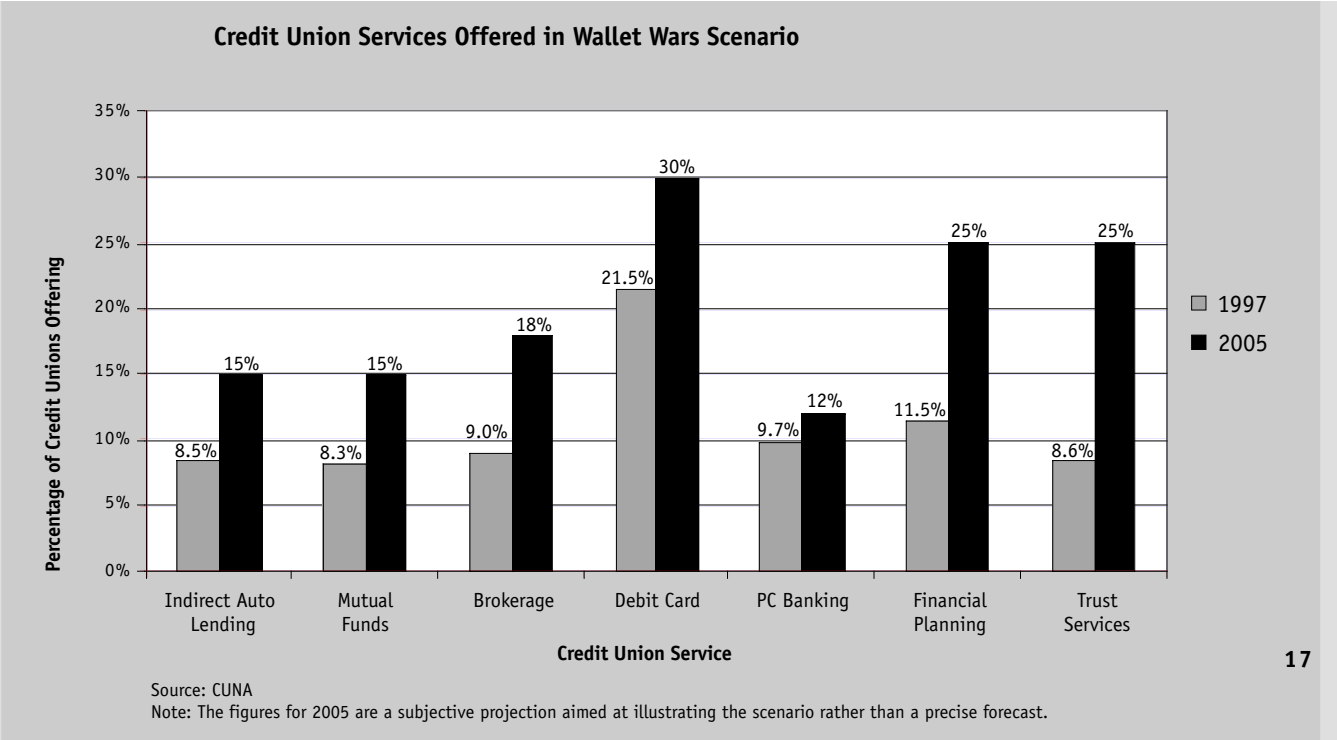
Large/small credit union distinction intensifies

Even in the late 1990s, it was hard to compare a \$10+ billion organization like Navy Federal Credit Union with some of the smaller organizations in the movement with assets below \$2 million. Whereas Navy FCU offers full services, its counterparts tended to offer only plain vanilla services. With a growing number of large credit unions, including behemoths such as State Employees Credit Union (\$6 billion), Boeing Employees Credit Union (\$2.5+ billion), and Pentagon Federal Credit Union (\$3 billion), smaller organizations were dwarfed.

The cultural, philosophical and managerial gaps between larger and smaller credit unions widen greatly in this scenario. Services offered, management structures and executive compensation systems are dramatically different for credit unions with \$400 million in assets than they are for those under \$20 million. In this scenario, the larger credit unions effectively compete with other financial services organizations, while smaller credit unions face substantial challenges. They simply don't have the resources to compete alone anymore. The scenario describes a world where the gap is so severe that large credit unions look much more like banks than traditional credit unions, and largely ignore their smallest brethren.

Credit union culture changes

In generalizing about credit union executives, some might depict their culture as safe, secure and committed. Most executives are hard working and tend to avoid risk. Banks, insurance firms and brokerage houses, however, often have very different cultures. They tend to be more comfortable with risk and more open to changes. Furthermore, new players are entering the financial services industry, such as Enron's move from producing and transporting natural gas to offering financial risk management or ING's strategy to



integrate insurance and banking into a global distribution and risk management strategy.

Upstarts in the financial services sector, such as Microsoft and Intuit, offer another interesting example, as aggregators of myriad financial services from various sources. Investment banks have always had a strong risk-taking culture on the trading side (at times to their detriment, as evidenced by huge losses in derivatives trading) and a deal-making culture on the corporate finance side.

As the playing field evens, with more crossover of employees between credit unions, banks and brokerage houses, this scenario depicts a world where the credit union culture starts to converge with other financial services organizations. Compensation systems, risk-reward profiles and quality of life are all realigned to better match the cultural norms of other financial services organizations.

Scenario C

Technocracy 2005: The Snapshot

The wide-scale adoption of the Internet by U.S. consumers has led to massive technological innovation for financial services companies, increasing the range of distribution channels as well as the products, services and geographic scope of financial services organizations. Regulations and other changes in the playing field, however, have been slow to follow.

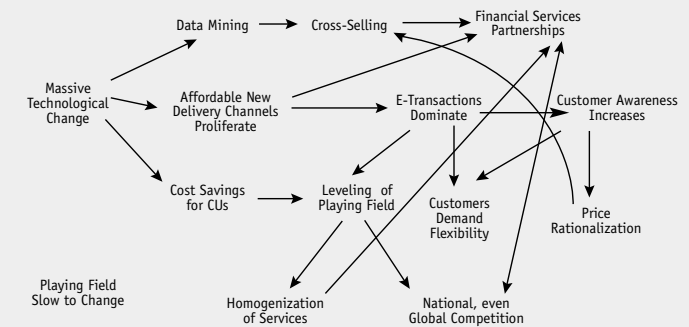
Key Themes: Highlights of Scenario C

- Radical changes in technology and minor changes in landscape
- Technology provides new opportunities to serve customers: call centers, Internet and new delivery channels
- Back-end technology decreases operations costs
- Technology allows credit unions to extend geographic boundaries and service offerings.

Member Behavior

The Internet infrastructure was built up so aggressively that the ways in which products and services are bought, sold and traded have fundamentally changed since the early 1990s. Starting with amazon.com, CDnow Inc., and eBay Inc. in the late 1990s, on-line and telephone purchasing are commonplace for all kinds of products. The e-commerce industry has grown to \$200 billion worldwide at a compounded annual growth rate of 150 percent. Indeed, consumers have become comfortable with electronic transactions and have overcome the range of privacy concerns that went hand in hand with e-commerce in its early stages.

Technocracy Scenario

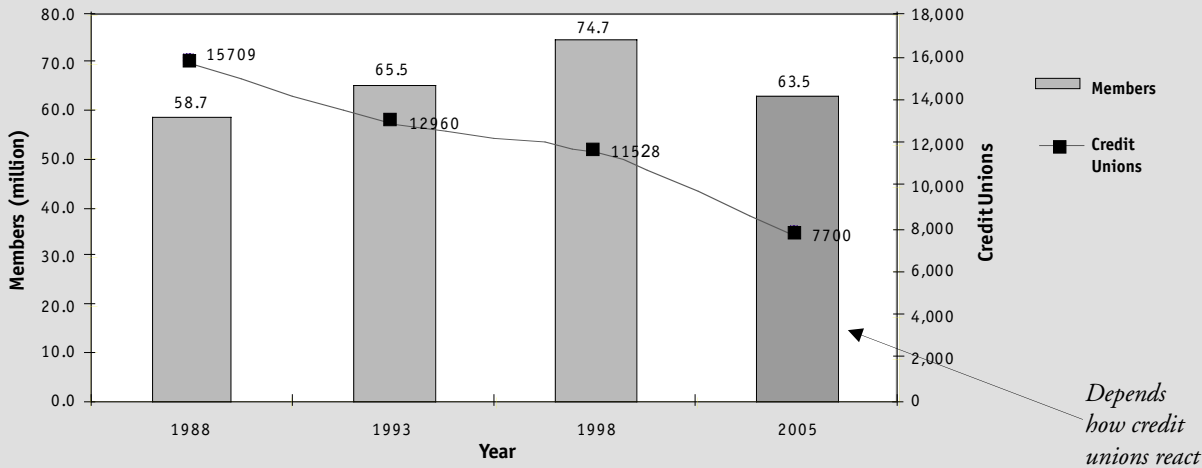


The growth of e-commerce has changed what consumers expect of their financial services organizations. In the aggregate, telephone, on-line and smart card transactions have surpassed in-branch visits for financial services. But members also look for flexibility. They want choices regarding which delivery channels to use—and they want to be compensated if they're using a delivery channel that is less costly to their financial services institution. The 80-20 rule regarding profitable customers (that is, 20 percent of customers make up 80 percent of a financial services company's revenues) no longer applies. Technology innovation and consumer awareness have led to a pricing rationalization so that profitable customers no longer subsidize their unprofitable counterparts.

Industry Structure

The proliferation of on-line transactions has led to large-scale deals that dwarf the multi-billion dollar deal among AOL, Bank One, Bank of America, Citibank, Union Bank of California and Wells Fargo of 1999. Technology improvements have enabled a certain leveling of the playing field among credit unions and other financial services companies. As these organizations have become more "virtual," they become an access point for a range of financial services—regardless of whether they're actually being offered by the "portal" organization itself.

Total Credit Unions and Members in Technocracy Scenario



Source: NCUA

Note: The figures for 2005 are a subjective projection aimed at illustrating the scenario rather than a precise forecast.

As a result of the portal concept, small credit unions compete effectively with large brokerage houses because they can offer the same products and services either directly or through their partners. Following standard Internet business models, portal financial services companies are paid a commission for transactions that stem from their organizations. A few credit unions report that over 50 percent of their revenue comes from strategic partnerships and co-branded products and services. Some are even venturing outside financial services in an effort to capitalize on the ever-growing e-commerce opportunity.

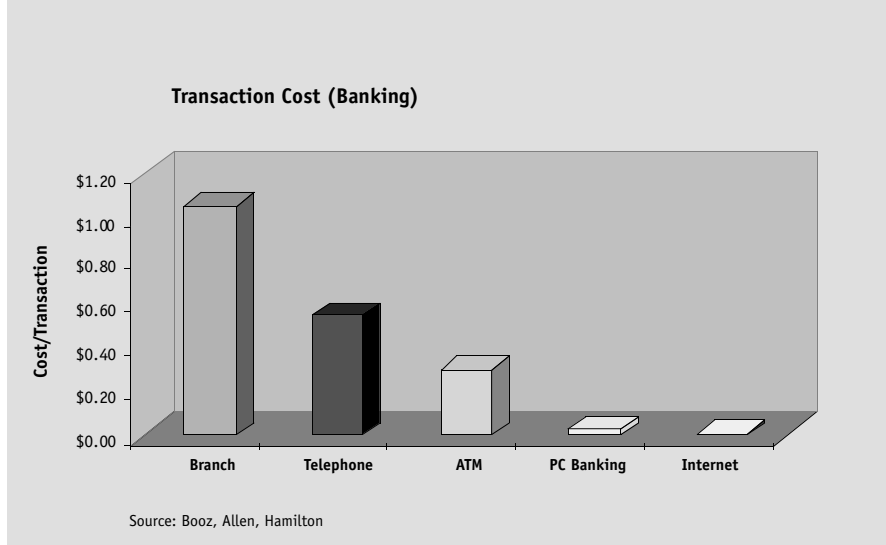
In addition, the emergence of a strong and secure network infrastructure has broken down traditional geographic boundaries. With the decreasing importance of bricks and mortar, it is much easier in 2005 to offer financial service to customers who live far away from the branch. This has led to nationwide competition for some credit unions and banks that would otherwise not compete. It also has resulted in the globalization of some credit unions, which can now serve expatriates and foreigners in a profitable way. Some credit unions follow the model of French and German credit unions and form large cooperatives that work together to achieve economies of scale while fiercely competing with other service providers. The Sparda Group of Germany, a conglomeration of 17 credit unions controlling about \$30 billion in assets, is the model for the American credit union's

Network of Credit Unions (NCU) in 2005, which will have 100 member credit unions representing close to \$100 billion in assets. The era of co-opetition (a term combining the words competition and cooperation) has arrived in the credit union industry, in this scenario, and players are forming alliances with real or potential competitors.

Technology

Technological breakthroughs have occurred at multiple levels. On one level, society at large is more technically savvy and literate. Roughly 75 percent of U.S. households have personal computers, which tend to be used for electronic commerce, e-mail and Internet browsing. In the U.S. workplace, employees are increasingly conducting more personal business on fast and efficient machines. By comparison, in the late 90's, roughly 40 percent of U.S. households had a personal computer, and less than 20 percent had modem access to the Internet. The proliferation of the PC into the home has helped to drive costs down even more aggressively than Moore's Law predicted, making technology cheaper and more powerful. (Moore's Law posits that the processing power for semiconductors will double every 18).

This cost reduction has driven the next fundamental breakthrough—delivery channel innovation and proliferation. It's finally economical to integrate new delivery channels into



financial services companies' back-end systems. Internet and telephone banking have become a must-have for almost all credit unions, banks and brokerage houses. A host of systems integrators and technology organizations has emerged to offer credit unions end-to-end systems at reasonable prices. Additionally, technology has created many cost-saving options for financial services companies—ranging from complete outsourcing of data processing, to loan and credit process streamlining. Many technical offerings that were formerly available only to large banks with large R&D budgets are now commonplace among smaller organizations.

Data mining has emerged as an opportunity for those organizations that embrace it—and as a threat for those that don't. Sophisticated data warehousing programs allow organizations to track consumers' financial expenditures, monitor banking patterns and anticipate future needs. Customer intimacy and one-to-one marketing are widely embraced by credit union managers. The ideal of serving every member's individual needs becomes closer every day. Top credit unions, banks and brokerage houses use these data to cross-sell products and guide product development efforts. This scenario validates former Citibank Chairman Walter Wriston's oft-quoted remark, "Information about money is more valuable than money itself."

Finally, there's increased acceptance of smart cards, or stored-value cards, that tend to be used in corporate or educational campus environments. Financial services companies are trying to understand how consumers will use these conveniences in the future and to identify the opportunities for revenue generation in both the short and long term.

Credit Unions

Once considered lacking in the field of technology, more and more credit union boards are becoming technology aficionados. They study where their members perceive the greatest value, and they're going after it. Experimenting with new business models, such as the portal concept, is still new for many credit unions. But success breeds comfort, and credit unions are becoming more comfortable with complex "virtual" organizations that are in essence tightly integrated partnerships among financial services companies.

Key Drivers

Taxation

In this scenario, larger credit unions are taxed but the negative impact of losing their exempt status is overcome largely by the offsetting benefits of greater access to additional members. Furthermore, credit unions can offer more services and, through the use of technology, can deliver these services custom-tailored to the membership. Yet here too credit unions will experience the accompanying changes in their organizational structure and the need for greater efficiencies.

Technology proliferates

If Moore's Law is correct, embedded microprocessors will proliferate, new types of consumer devices will emerge and consumers will become substantially more technically savvy.

As a result of these technical developments and accelerated consumer adoption curves, financial services companies will have new delivery channels, efficient back-end systems and new ways of doing business, all enabled by information technology.

As a point of reference, Forrester predicts that on-line mortgage lending will grow from \$18 billion in 1999 to over \$91 billion in 2003. Such growth will lead to on-line transactions accounting for roughly 10% of all mortgages. Interestingly, in the late 1990s, some credit unions viewed technology as a threat, when in fact it went on to become a great opportunity.

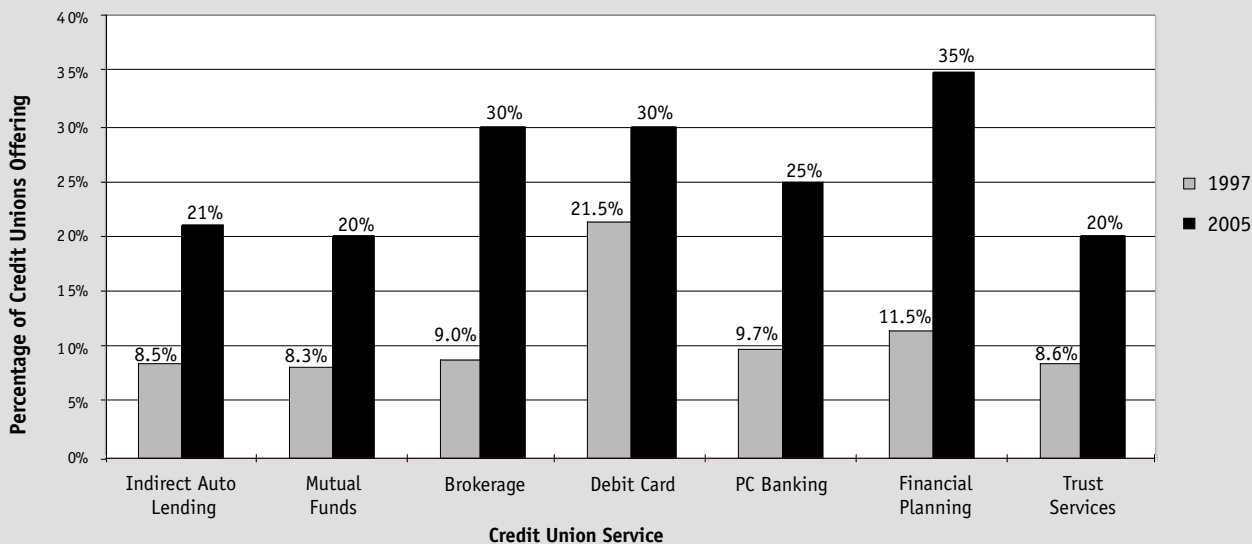
This scenario depicts a world where technological innovation in the financial services industry makes it perhaps easier for credit unions to compete with larger banks and brokerage houses. However, in this world, technology-savvy consumers do demand that their financial services companies offer digital delivery channels, and that they share in the inherent cost savings through price reductions and incentives for using electronic delivery channels. Financial services

technophiles believe that growth in technology levels the playing field for credit unions in ways that regulations could never have achieved.

Portal business models win

Today portal business models are the hottest thing in Silicon Valley and on the Internet. When Netscape was the browser company, its stock traded in the mid \$20s per share. When it became “the portal company,” focusing its resources around its Netcenter Web site offering, Netscape’s stock soared to the mid \$70s. More than just market capitalization, though, portal business models represent a whole new way of doing business for technology companies and their partners. Their biggest feature is that they allow “virtual organizations” to participate in commerce. In portal economics, customer loyalty and brand identification are rewarded with recurring revenue streams and percentages of transactions. Building traffic and loyalty through compelling content is what matters most in the world of portals.

Credit Union Services Offered in Technocracy Scenario



Source: CUNA

Note: The figures for 2005 are a subjective projection aimed at illustrating the scenario rather than a precise forecast.

In this scenario, banks offer products and services to their customers through their financial services portals. If a credit union wants to sell insurance, handle stock trades or sell mutual funds, it builds dynamic links to its portal and collects a percentage of each transaction. In this future, portal-based business models play a key role in providing new sources of revenue for credit unions. There's strong evidence that these models will indeed succeed, as seen by the proliferation of auto-buying sites such as autobytel.com and CarPoint.com, which also assist consumers in the financing process. Forrester forecasts that by 2003, 1.2 million U.S. households will finance, insure, and handle warranties on-line.

Data mining drives cross-selling

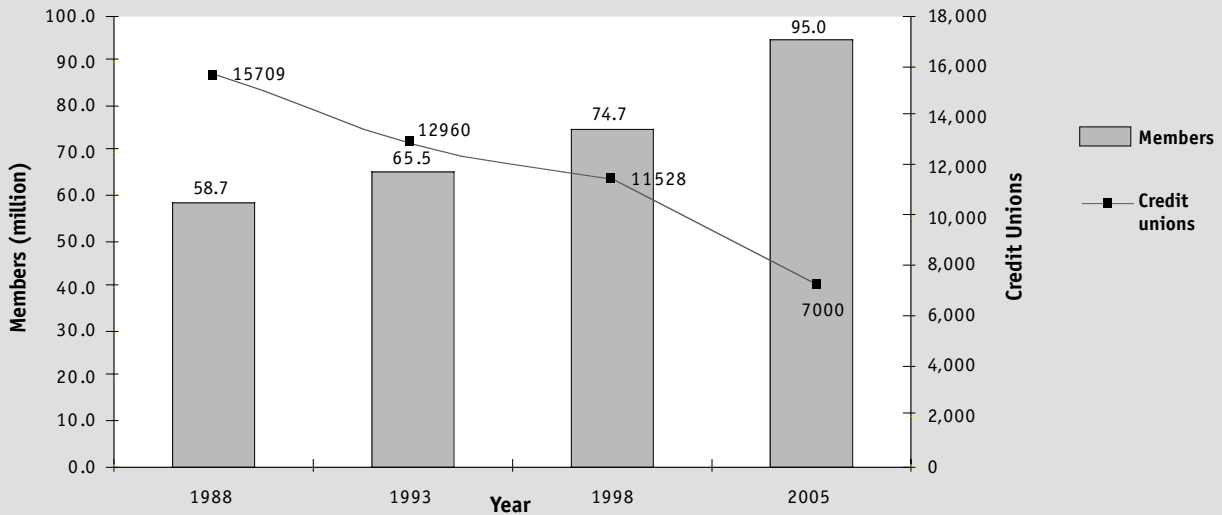
Databases of customer information are highly sought after by marketing executives around the world. With advances in technology and the increasing digitization of the economy, the value of these databases increases significantly. Sophisticated databases track customer preferences, interests and perceived needs; they can tailor marketing messages to customers instantaneously. All this adds up to highly pleased customers and increased cross-selling opportunities.

In this scenario, database management becomes a key success factor for financial services companies. Powerful databases combined with effective marketing strategies lead to fundamentally new ways of designing and marketing products to consumers. Credit unions use these databases to better understand member needs and to cross-sell products, services and features. Furthermore, they sell their insights and data base access to third parties.

Alliance and partner management

This scenario is full of talk about partnership management, "co-opetition" and relationship building. While alliances and strategic partnerships have always been prevalent in the financial services industries, there's a new way of thinking about them. Today, executives consider their partners to be strategic assets, not necessary evils or threats. The foundation of this scenario rests on a proliferation of alliances among financial services companies. In the world described here, virtual networks of organizations provide aggregate services to consumers in ways that a single organization couldn't possibly provide. As a result, credit unions covet strategic relationships, and credit union executives spend a high percentage of their time nurturing them. The era of "web organizations" has arrived in more ways than one.

Total Credit Unions and Members in Chameleon Scenario



Source: NCUA

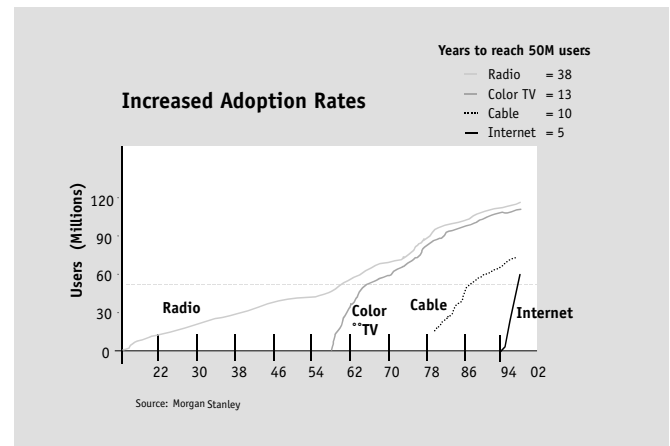
Note: The figures for 2005 are a subjective projection aimed at illustrating the scenario rather than a precise forecast

unions to both a national and an international audience. They use slick advertising agencies known for launching “edgy” advertising campaigns that take on banks and brokerage houses directly. In addition to outbound marketing, the nationwide federation provides quality assurance and back-end technical support for many credit unions, allowing them to enjoy economies of scale. This reduces operational costs and R&D budgets while increasing efficiency, all of which are strategic necessities in this extremely competitive marketplace.

Credit unions are increasingly forming alliances with unlikely partners such as technology companies, as well. Microsoft’s financial services division has 50 employees devoted full-time to credit union relationship management, and more than 80 percent of credit unions are institutional members of the Microsoft Financial Network. The technology superpower offers software, services and support for credit unions. Indeed, dynamic partnerships exist among credit unions with technology companies, and with other financial services companies, making “alliance relationship enhancement” a critical skill for credit union executives.

As credit unions are taxed in this scenario, field of membership restrictions have been lifted. The Department of Justice now approves mergers and acquisitions as the NCUA has ceased to exist as a separate regulatory agency. All financial services contenders must follow the same rules. At an accel-

erated pace, some financial services organizations are beginning to look outside the United States for growth opportunities. Credit unions have had early successes in China, Russia and parts of Eastern Europe, where the competition is not as fierce as in the United States and Canada, and where the needs of the underserved remain real and significant in size.

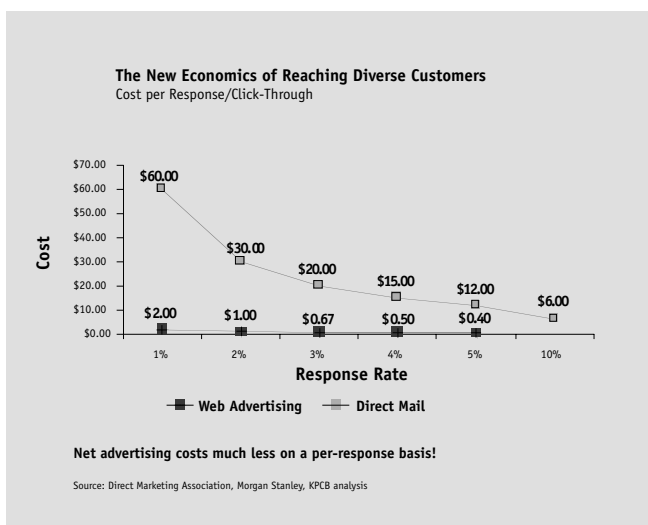


Technology

Technology has brought accelerated innovation to the credit union arena. In addition to back-end operational efficiency, tremendous technological innovation has driven the launch and promulgation of new delivery channels. Internet and telephone banking, smart cards, ATMs and other forms of nonbranch banking have far surpassed in-branch services as the delivery channels of choice for most members. New

types of consumer devices and new outlets for accessing financial services have surfaced. The popularity of mainstream services such as Web TV have led to specialty applications allowing consumers to access financial accounts and data from the living room television.

All of this technological innovation has also contributed to the globalization of credit unions and other financial services companies as the importance of geographical location has diminished. The national credit union federation has made large investments in technology innovations that allow its members to keep up with other financial services companies' technological capabilities.



The most exciting innovation for credit unions, though, has been around information-based product development. Rich databases allow member service representatives—real and virtual—to configure products and services specifically for individual members. The software programs develop relationship pricing based on a combination of the lifetime net present value of a member, a snap assessment of the individual's needs, and a clear picture of his or her financial status. Customized products, services and prices allow financial services companies to cherry pick customers. The downside has been that others have skimmed some of the profits from competitors that were benefiting from highly profitable customers before these programs were launched.

Credit Unions

Most credit unions don't look much like they did in the 1990s. There's an enormous wedge between the larger credit unions and the smaller ones. Many of the larger credit unions resemble the banks of the late 1990s. Their management structure, style and incentive systems tend to be closely aligned with banks and investment houses. With so many mergers and acquisitions occurring and with the incentives for being a credit union diminishing, several credit unions have chosen to convert their charters to banks. Many of those that haven't are at least considering doing so—especially when investment bankers build the case (and show the personal gains) as part of an acquisition proposal.

All of this has made some boards of directors extremely frustrated. They feel the old-time values of credit unions are dwindling. They're right. The competitive marketplace makes it nearly impossible to subsidize some members for the benefit of others. In this 21st century marketplace, traditional credit union values can only be maintained to the extent that they lead to increased customer retention or acquisition.

As is often the case when the environment changes quickly, some credit unions that trumpet traditional values as their primary differentiation are benefiting from a backlash against consolidated financial services giants. They're focusing on the historic mission of credit unions as a way to attract customers. Additionally, credit unions are being challenged by accelerated product development life cycles. Credit unions face the fast-paced reality that constantly calls for iterative product development, aggressive product launches and innovative thinking.

Key Drivers

Taxation

Credit unions are taxed like community banks. However, as in previous scenarios there are trade-offs for taxation. Broader fields of membership, opportunities to offer more services, compensation of managers and staff on par with other financial services firms, and compensation of boards give credit unions better tools to compete. At the same time these changes drive a further wedge between big and small credit unions. Some big credit unions are likely to pay their boards of directors fees comparable to bank director fees, which run roughly \$14,000 per year for outside directors and \$9,500 for inside directors, according to Bank Administration Institute.

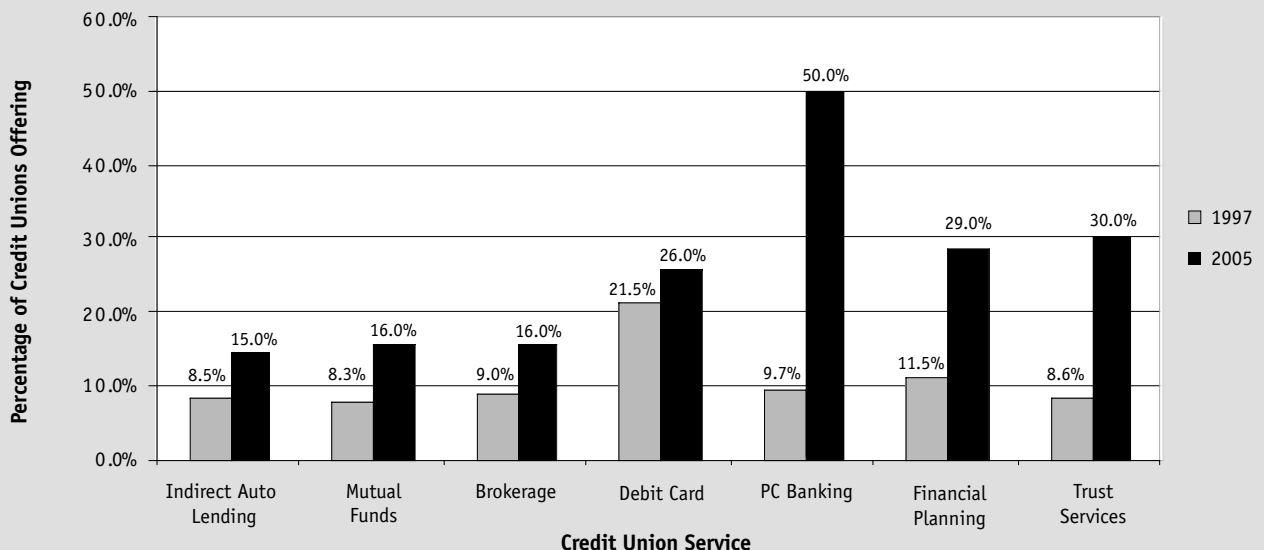
The old-time ideals of the movement increasingly give way to the imperatives of a competitive business climate. In reaction, some credit unions opt out of the growth model and focus exclusively on limited services for a limited core group related to a single sponsor, church group or other limited affiliation. They present themselves as the “guardians of the old ideal,” and there is a role for such purists, be it a limited one.

Customization and personalization

The success of the Internet and growth of an e-commerce economy has spawned a growing interest among marketers and product developers for customized products. Just as Dell Computer Corp. and Gateway created built-to-order computers for consumers in the late 1990s, customization is starting to become a necessity in other industries as well, including clothing, real estate and, in this scenario, financial services.

This world depicts a future in which consumers expect offerings to be tailored to their unique needs. Those with outstanding credit want lower interest rates for loans. This scenario takes that concept a step further. Some consumers want their loan payments due on their pay day. Others want to be able to skip payments during the Christmas holiday season. Still others want incentives for paying off their loans earlier. And many want financial advice across the bewildering spectrum of financial service offerings. Whatever their need, consumers expect it to be met at a fair price, or they go elsewhere.

Credit Union Services Offered



Source: CUNA

Note: The figures for 2005 are a subjective projection aimed at illustrating the scenario rather than a precise forecast.

Credit unions unite

We've already mentioned the theme of co-opetition, in which competitors form partnerships with each other to further their independent and collective needs. To a greater extent, credit unions develop strategies that combine competition and cooperation in novel blends to create new business models. In this scenario, credit unions work together to battle the banks, brokerage houses and financial services companies. They launch an aggressive marketing campaign to gain new members and expand the services existing members use.

Globalization of credit unions

In the late 1990s, according to the World Council of Credit Unions, the bulk of credit union activity was concentrated in North America, which represents roughly 76 percent of worldwide credit union membership but only 32 percent of the total number of credit unions worldwide. Asia emerges as an intriguing market place for credit union expansion. With the highest concentration in Korea and Sri Lanka, the Asian region already had 40 percent of the world's total credit unions. Most of these credit unions provided alternative financial services in the form of micro-credit, economic development projects and basic financial services.

In this scenario the credit union movement expands rapidly across geographic boundaries. Changes in tax law, developments in technology and hyper-competition make expansion attractive for credit unions. Additionally there's a strong need for micro-loans and other community development programs in parts of Asia, South America and Africa, as well as Eastern Europe making it an even more attractive expansion opportunity for the movement. These dynamics make it easier for credit unions to gain momentum outside the United States than domestically. As business globalizes, so do credit unions.

Traditional values challenged

With its roots in cooperative activities in 19th century Europe, the credit union movement's guiding principles remain relevant: Loans are made for "prudent or productive" purposes to individuals who are credit union members and who have strong character, not necessarily to individuals who have the strongest ability to repay. These values are entrenched in the credit union movement and are considered by many to be the core of the movement.

In this scenario, those values are challenged. As banks and brokerage houses tread—rather roughly—on credit union territory, more and more credit unions find it impossible to maintain those ideals and remain solvent. As its values are challenged so is the very essence of the credit union. Not surprisingly, this trend means difficult adjustments for those who built their lives and careers on the foundation that Roy Bergengren and Edward Filene enunciated many years ago.

Conclusion

After reading these scenarios, the question you should NOT be asking is which scenario will come true but, rather, what strategies your organization should pursue to embrace the various possibilities. In general, there are four fundamental strategies to reinvention for financial services organizations. How much emphasis to give to each of these strategies depends on how much weight you give to each scenario, as well as the specific circumstance of your credit union. Let's briefly explore each of the possible reinvention strategies with examples drawn from the financial services industry:

- 1) **Reconfiguring the Value Chain**—Chase Manhattan Investment services formed relationships with 300 investment companies to offer comprehensive individual portfolio management for consumers. Through these relationships, Chase altered the traditional value chain, better matching the needs of retail customers. Credit unions are also doing this, but in a more limited sense, through the proliferation of shared branch and ATM networks.
- 2) **Channel Innovation**—Bank of America, and many other financial services institutions, realized that consumers want more choice in how they communicate and interact with their banks. As a result, BofA launched a transaction site on America Online, the Internet, as well as through kiosks and telephone banking. These new channels allow for greater customer intimacy at lower costs. A number of credit unions are teaming with CUSOs and discount brokerage firms to offer a hybrid version of on-line and full-service brokerage features for their members.
- 3) **Leveraging Information Technology**—In the early 1990s, Capital One, the credit card company, launched an aggressive database-driven strategy. Rather than blanketing consumers with

credit card offers, Capital One started a “test cell” strategy. The company's marketing department sends mailings to hundreds of test cells to learn about customer demand and performance. The information gathered from these test cells is used to generate comprehensive offerings and large-scale campaigns. The company increased credit card receivables from \$1.7 billion in 1992 to \$9 billion in 1994 due, in part, to this program. A credit union in California currently conducts 80% of its transactions virtually, through home banking, call centers, kiosks and ATMs.

- 4) **Product or Value Innovation**—Security First Network Bank realized that an important segment of consumers wanted to do all of their transactions via electronic delivery channels. As a result, they launched a bank exclusively for e-customers with special rates, promotions, and programs to meet the needs of this customer set. At the time of their launch, they didn't have any bricks or mortar. Credit unions are increasingly implementing data warehousing and data mining in order to segment their membership based on individual needs and wants.

There are countless other examples of these approaches to reinventing your organization, and there may be other strategies as well that should be considered. We encourage you to explore what it would take for your particular organization to succeed in each scenario separately, and then to examine which strategies make sense in all scenarios. Such an examination will help you determine how far to stick your neck out in certain products, markets, channels and technologies, while also reminding you to build in flexibility and to keep tracking in which direction the external world is evolving. In our strategy workshops, we present more systematic approaches to devising strategies and plans that fit the scenarios, resulting in an overall vision of how the organization must change.

In general, we believe that several key success factors will prove invaluable in several of the scenarios, albeit to varying degrees. These include:

- Information Management—The ability to collect, manage and analyze consumer and financial information in a more sophisticated manner.
- Business Development—The ability to identify, maintain and nurture partnerships within and beyond credit union land.
- Change Management—The ability to launch new products and services frequently and iteratively and to take risks appropriately.
- Technology Management—The ability to understand, embrace and utilize information technology to improve operations and re-shape existing offerings.
- Channel Innovation—The ability to offer products and services through multiple channels, including direct channels, such as ATMs and e-banking, and indirect channels, such as strategic alliances.

Scenario planning is above all a tool to change people's mindsets, which is a necessary condition to bring about lasting change in any organization. However, it is also a tool for identifying key success factors i.e., understanding in detail what it will require to be successful in different futures. Each organization must devise its own set of key success factors, depending on the specific circumstances it finds itself in. Furthermore, your credit union's strategy will be different from others depending on your current mix of skills, resources, capabilities and ambition.

The future is dynamic—it is very much a moving target. Your challenge is to use our scenarios as a backdrop for outlining a strategy that will allow you to navigate the opportunities of the future. Also, you may wish to revise or elaborate the scenarios to better reflect your particular situation. We offer these industry scenarios as a starting point for a strategic conversation with your senior management team and board. Please share, discuss and debate them.

Appendix A

The Scenario Planning Process

The scenarios outlined in this report are based on interviews with roughly 30 credit union executives, board members and analysts. Using the Decision Strategies International methodology, we assembled a list of forces, conducted an on-line survey of 150 executives and board members, identified key trends and uncertainties, created a key uncertainty matrix, developed a blueprint, and developed the scenarios.

Step One: Conduct Interviews

The following people were interviewed as a part of this study:

1998-1999 CUES Board Members:

- Edwin R. Bigby Jr., president & general manager, Norbel Credit Union, Greeley, Colo.
- Wayne Bunker, CCE, president/CEO, Commonwealth Central Credit Union, San Jose, Calif.
- Rick Craig, president/CEO, America First Credit Union, Salt Lake City, Utah
- Sharon L. Custer, president, BMI Federal Credit Union, Columbus, Ohio
- Mary Cunningham, president/CEO, CUNA Credit Union, Madison, Wis.
- Mark Heth, president/CEO, Iowa Community Credit Union, Waterloo, Iowa
- Gary W. Irvin, CCE, president/CEO, Indiana Telco Credit Union, Indianapolis, Ind.
- Tom Randle Jr., CCE, president, Sarasota Coastal Credit Union, Sarasota, Fla.
- Bill Rissel, president/CEO, Fort Knox Federal Credit Union, Fort Knox, Ky.
- Catherine S. Robertson, CEO, Gimli Credit Union, Gimli, Manitoba, Canada
- Patsy Van Ouwerkerk, CCE, president/CEO, Alliance Federal Credit Union, San Jose, Calif.
- Mickey Wilson, president, Greater Warren Community Federal Credit Union, Warren, Ohio

Analysts, Journalists and Consultants:

- Frank Diekmann, editor/co-publisher, *Credit Union Journal*, West Palm Beach, Fla.
- Peter Duffy, SVP/investments, First Empire Securities, Hauppauge, N.Y.
- Charles Filson, president, Callahan & Associates, Washington, D.C.
- Dr. Carl Fredrickson, president, Carl Fredrickson & Associates, Middleton, Wis.
- Harold O. Fried, Ph.D., professor of economics, Union College, Schenectady, N.Y.
- Bill Hampel, Ph.D., chief economist, CUNA & Affiliates; director, CUNA Credit Union, Madison, Wis.
- Robert F Hoel, Ph.D., executive director, Filene Research Institute, Madison, Wis.
- John Oliver, president, Laurel Management Systems, San Francisco, Calif.
- Mike Welch, publisher, *Credit Union Times*, West Palm Beach, Fla.

The following group of CEO Institute alumni also provided essential feedback on this project as part of the CEO Institute Alumni meeting during CEO Network '98 in Phoenix, Ariz:

- Kenneth Burns, CCE, president/treasurer, Technology Credit Union, San Jose, Calif.
- Kathleen Elliott, CCE, SVP/creative operating officer, Best Source Credit Union, Pontiac, Mich.
- J. Stewart Fuller, CCE, CEO, Monterey Federal Credit Union, Monterey, Calif.
- Andrew Jaeger, CCE, president/CEO, NJDOT Credit Union, Ewing, N.J.
- Christopher Moran, CCE, president/CEO, General Electric Employees Federal Credit Union, Fairfield, Conn.
- Ronald Oleston, CCE, president/CEO, Penfield Federal Credit Union, Rochester, N.Y.
- William Rayhill, CCE, president/CEO, Redwood Credit Union, Santa Rosa, Calif.

The following group reviewed the final content and gave feedback:

Dan Clark, President/CEO, Tallahassee-Leon FCU, Tallahassee, Fla.

Warren E. Marshall, President/CEO, Stanford FCU, Palo Alto, Calif.

Lary B. McCants, CCE, President/CEO, IBM Southeast EFCU, Boca Raton, Fla.

David W. Trafton, CEO, Meadows CU, Arlington Heights, Ill.

Attendees from CUES' 1999 CEO Institute I at the University of California-Berkeley

Step Two: Create Forces

Based on the interviews, DSI identified 53 forces that might impact the credit union industry in the coming years.

Step Three: Administer Survey

After developing the forces, we conducted an electronic survey to help categorize forces as trends and uncertainties.

Step Four: Identify Key Trends and Uncertainties

The survey results led to a list of trends and uncertainties. Trends are those important forces in the future that are highly predictable. The key trends derived from the survey included:

F5 Customer knowledge continues to improve dramatically.

F12 Baby boomers redefine aging and retirement.

F15 Credit union consolidation continues in the United States.

F22 Expansion of fields of membership continues.

F24 Non-bank financial services providers increase share.

F26 Credit unions are increasingly embraced as "trusted mediator."

F34 Internet banking increases.

F35 Telephone banking increases.

Uncertainties are those important forces in the future that may have different outcomes; such as:

F6 Will credit unions enjoy an increasing wallet share?

F7 Will new channels of distribution proliferate for credit unions?

F13 Will the economy experience a significant downturn?

F16 Will credit unions be taxed in the United States?

F32 Will most Americans have Internet or broadband access?

F46 How much will credit union member loyalty go down?

F48 Will credit union car loan volume see a major decrease?

Step Five: Create Key Uncertainty Matrix

The key uncertainty matrix provides anchors for developing the scenarios. In this study, we used two key uncertainties. The first is changes in technology, which deals with the nature and pace of technological progress. A minor change means networking and new delivery channels grow at the rate most analysts are currently predicting; a radical change means the growth rate and effects on the financial

services industry accelerate even faster. The second key uncertainty is changes in the playing field. A minor change means the rules, regulations, players and bases of competition do not change dramatically, while a radical change translates into substantially different ways of doing business.

Step Six: Create Blueprint

The blueprint is a map of all the strategic uncertainties played out for all the scenarios. Each uncertainty is assigned specific outcomes that best fit each scenario theme. An abbreviated blueprint can be found in the original report.

Step Seven: Write and Validate Scenarios

Finally, we meld the blueprint with trends to create scenarios for the future. Following the initial draft, we validated the scenarios with key industry thought leaders and executives who attended CUES' CEO Institute at Berkeley in the spring of 1999, with Paul Schoemaker as the lead faculty member.

For more information on the scenario development process, you may wish to consult some of the the following sources.

- Randall, D., "Consumer Strategies for the Internet: Four Scenarios," Long Range Planning, Vol. 30(2), 1997, pp. 157-168.
- Schoemaker, P.J.H., "How to Link Strategic Vision to Core Capabilities," Sloan Management Review, Fall 1992, Vol. 34(1), pp. 67-81.
- Schoemaker, P.J.H., "Scenario Planning: A Tool for Strategic Thinking," Sloan Management Review, Vol. 36(2), Winter 1995, pp. 25-40.
- Schwartz, P., The Art of the Long View, Doubleday Currency, 1991.

Appendix B:

CUES/CUNA Mutual Group Strategic Services

CUES/Decision Strategies International Scenario-based Strategic Planning Services, www.cues.org, click on "Services", including two-day workshops to help jump start your credit union's strategic planning process

CEO Institute, www.cues.org/education/ceoinst.htm, incorporating the faculty, facilities and resources of three of the world's top business schools

CUES Online University, www.cuesu.org, a comprehensive, convenient online staff and board training solution

CUES Tech Port™, www.cuestechport.com, the ultimate online portal for technology purchasing, research and advice

Forrester Research Service, www.cues.org, click on "Services", vital technology research data and analysis at a fraction of the market price

Directors Leadership Institute, www.cues.org/education/dli.htm, world-class, future-focused director learning, at London Business School

Executive Benefits Program, www.cunamutual.com/custaff/empbenefits/execbenefit.asp, highly consultative approach to designing an executive benefits plan for your management team. CUES has agreed to help CUNA Mutual develop and promote the program, due to its unique relationship with credit union executives.

CUNA Mutual Group's Web site, www.cunamutual.com, a complete resource of financial and insurance services offered to help ensure financial security for credit unions and their members.



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