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Breaking through to the future

The strategic development of credit unions in Britain, 1998 – 2008

INTERIM REPORT SUMMARY

4th December 2008

In December 1998, the research report, 'Towards Sustainable Credit Union Development', was launched. It revealed that many credit unions, especially those in the community, had been established according to a particular social development model. This resulted in slow growth, financial weakness and many being unable to serve more than a few hundred members. The 1998 report argued for a business-focused approach to development.

The report provided a catalyst for change in the credit union movement. It stimulated a 10-year process of transformation that has resulted in the emergence of a new modernised British credit union movement.

The 2008 research, "Breaking through to the future", has explored the impact and the scope of change in the credit union movement since 1998 and identified the key strategic issues for the future.

- *British credit union membership has tripled in last 10 years.*
- *In 1997, only 3.6% of all British credit unions had over 2,000 members. In 2007, 23.3% have over 2,000 members.*
- *The national loan portfolio has quadrupled since 1997. Credit union savings have risen by a factor of 4*
- *Opening hours and accessibility of credit unions has changed markedly in the last ten years.*
- *Two thirds of credit unions polled state that government policy has helped credit unions in recent times. Three quarters of those polled said that delivering DWP Growth Fund loans has directly assisted the growth of their credit union.*
- *Low-value loans are often unprofitable and will not, on their own, contribute to the wealth and health of credit unions.*
- *Credit unions need to offer a much wider range of updated financial products and services to meet the needs of the modern consumer.*
- *Financial efficiencies and successful business should be sought by credit unions to fund and enable social objectives.*
- *Boards of directors need to demonstrate leading governance to maintain the good reputation of ethical and social businesses.*
- *83% of credit unions said they would be prepared to collaborate with other credit unions on a much greater scale than at present in order to deliver a greater range of products and services.*
- *70% of live or work credit unions agreed that credit unions must offer a range of financial products and services to suit different segments of the market and ensure that the credit union brand is recognised as mutual and local, and as offering quality financial services to all.*

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Breaking through to the future

As in 1998, the 2008 research engaged credit union personnel in a collaborative inquiry into the strategic development of the credit union movement. Methodology involved: a PEARLS¹ statistical analysis of the annual returns for 2006 and 2007 of 216 credit unions, a national survey (a 23% return), 6 round table discussions with 53 directors and managers, ten case studies, consultations with stakeholders and desk research into the process of change since 1998.

Credit union growth

From 1997 to 2007, credit unions increased membership by 170%, savings by 318%, loans by 298% and assets by 351%.

At year end 2007, there were 501 credit unions with 607,400 members, with savings of £449m and loans of £393m. Total assets were £599m.

At year end 1997, there were 596 credit unions with 224,674 members, with savings of £107m and loans of £99m. Total assets were £124m.

In 1997, the average membership of a credit union was 377. By 2007, this had grown to 1,212. In 1997, 56% of British credit unions had less than 200 members. In 2007, only 13% of credit unions had less than 200 members. In 1997, only 3.6% of all credit unions had over 2,000 members. In 2007, 23.3% of all credit unions had over 2,000 members.

Statistical analysis demonstrated, however, that some long-established credit unions are finding it hard to grow membership. Overall, credit unions established over 20 years ago are only growing membership by 2.4% per annum.

Credit unions are increasing assets and collectively exceeding the PEARLS target of 10% plus inflation. However, credit unions over 21 years old are only increasing assets by just over 3% per annum.

Measuring progress

Internationally, credit union development is often measured against seven 'doctrines of success'². These were adapted to suit the British context and used to measure progress since 1998 as revealed through the empirical research. These are:

1. Serving the financial needs of a diverse membership

70% of live or work credit unions, which include former community credit unions, now identify as a financial institution, co-operative or social enterprise. 76% define their purpose in terms of offering a financial service to an economically diverse

membership. In 1998, 83% of community credit unions identified as a community development project or a service for disadvantaged people.

78% of survey replies were from live or work credit unions and just 14% were from work-based credit unions. Live or work credit unions, often established through amalgamations of local authority employee and former community credit unions, have emerged strongly since 1998. They offer financial services to the whole community.

96% of survey respondents said the most important factor in the development of their credit union was the relationship with members. This is a change in perspective since 1998. Then, 99% of replies from community credit unions prioritised volunteer support. Credit unions have endeavoured to become more member driven organisations.

Member driven means being open and accessible. 56% of credit unions, and 61% of live or work credit unions, now have at least one staffed high street premises, open 5 days a week. This is in marked contrast to the situation in 1998, when 62% of all community credit unions were only open for six hours a week or less. Then only 17% of community credit unions operated from their own premises, with most working from community centres, churches, volunteers' homes or local authority premises. 26% of community credit unions operated out of volunteers homes. In 2007, only 13% of credit unions are open for 6 hours a week or less.

2. Attracting savings

Credit unions are funded through savings and not primarily by external funds granted for on-lending. The overall savings to asset ratio is 83%. There was a 3% decline from 2006 to 2007, probably due to the Growth Fund.

In 1997, credit unions were overwhelmingly borrower-oriented organisations. In 2008, round table participants related how savers need attracting to credit unions and how future deregulation on savings accounts will help.

Of the 216 credit unions for which data was available, 146 now paid a dividend on savings (68%).

3. Products and Services

Round table participants argued that many credit unions have re-thought their position in the market and have introduced more commercially aware approaches to the business. Many now aim to offer different groups of people the sorts of financial products they want and need.

The products and services that credit unions offer have changed markedly since 1998. 52% of live or work credit unions now offer loans not linked to savings balances, 51% offer Christmas savings schemes, 43% offer benefit direct accounts, 82% an annual dividend on savings and 57% offer loans at varying interest rates. 7% offered the Child Trust Fund and 8% cash ISA's.

¹ ABCUL (2004), An Introduction to PEARLS in Britain, ABCUL. PEARLS is a sophisticated financial management tool capable of measuring key areas of credit union operations

² Richardson D.C. (2000), Unorthodox Microfinance: The Seven Doctrines of Success. Microfinance Bulletin Calmeadow USA February

The aspiration of credit unions to offer enhanced products and services has also changed. 64% of live or work credit unions either plan to or would like to offer the Credit Union Current Account in the future. This falls to 35% among work-based credit unions.

44% of live or work respondents saw their credit union offering a full banking service within the next 10 years. This declined to 29% among work-based credit unions, 59% of which preferred to remain as savings and loans organisations only.

4. Financial discipline

For many round table participants traditional social model assumptions had given way to a new set of perspectives and beliefs based more firmly on economic and financial realities. Credit union learning since 1998 has been that credit unions have to succeed economically if they are to attain their social objectives.

With very few exceptions, financial analysis demonstrates that British credit unions are solvent organisations. Collectively they also meet the PEARLS target of 10% institutional capital. However, individually, 26% of credit unions had less than 3% capital reserves and 17% had less than 2%.

With few exceptions, credit unions meet or exceed provisioning targets for bad debt. This is a major advance on 1997 when provisioning for loan loss was minimal.

PEARLS analysis demonstrated the continuing importance of external subsidies to credit unions in England and Wales, particularly those registered less than 10 years. Overall, Scottish credit unions appear the least grant dependent, but this is probably because of the incidence of a number of large independent credit unions. Grant income appears to be in decline in Wales.

5. Operating efficiency

Credit unions can only offer competitive rates of interest on loans and pay attractive dividends if they are financially efficient organisations. 96% of survey respondents reported that IT and computerisation is important to credit union development, and key to the development of credit union efficiency, probably as in 1998 many credit unions did not use computers and kept accounts manually.

However analysis revealed that operating expenses are often high and exceed targets in England and Wales. They are double the PEARLS target ratio in Wales. They are more on target in Scotland. It was clear in some case study credit unions that as credit unions, often with the support of grants, hire staff and take on premises, they can struggle to generate sufficient income to cover costs when external grants come to an end.

Analysis also revealed that certain groups of credit unions are not lending sufficiently to generate sufficient income to meet core costs.

In order to gain economies of scale, 20% of survey respondents considered that their credit union would amalgamate with another credit union over the next ten years.

83% of credit unions, rising to 88% of live or work credit unions, said they would be prepared to significantly collaborate with other credit unions on a much greater scale than at present in order to deliver a greater range of products and services.

6. Governance and management

76% of respondents felt that leadership in their credit union came primarily from the board. However, 76% also reported difficulties in recruiting sufficient skilled directors, particularly in work-based credit unions. More work-based respondents (70%) were confident that boards had the requisite skills and capabilities than were live or work respondents (56%).

83% of live or work credit union respondents, 82% of work-based respondents and 71% of residential respondents said that their credit unions employed paid staff. In 1998, 78% of work-based credit unions had paid staff, but only 10% of community credit unions did.

With the introduction of the business model, round table participants stressed the increasing professionalisation of credit union operations, now seen as essential to building stronger credit unions. Participants focused on the importance of business planning, operating, communication and reporting systems, of defined staff and volunteer roles and responsibilities, of financial control mechanisms, of management information systems and of robust employment practices.

44% of live or work, 24% of work-based and 88% of residential respondents said that their credit unions could not operate without volunteers. In 1998, 90% of community credit unions said they could not operate without volunteers.

The growth in of the number of employed staff is a major change in the sector, but round table participants reported that many credit unions still find it difficult to afford the costs of engaging qualified and experienced managers. It is only now in some credit unions, that a credit union career structure is beginning to emerge, with the consequent opportunity for career advancement within the movement as a whole.

7. Providing a pathway to financial inclusion

Credit unions operate in the low income market. 82% of live or work credit unions, and 85% of residential credit unions, identify home credit companies or other sub-prime lenders as the main competitors. In comparison, 71% of work-based credit unions identify banks or building societies.

Participants recognised that serving low income members effectively depends on offering people access to current accounts, savings accounts, affordable credit insurance, money advice and

financial capability education. Only by providing a pathway into financial inclusion can the financially excluded be brought into the mainstream. 67% of live or work credit unions have a relationship with a money advice agency to which they can refer members.

However, many were concerned that the focus on financial inclusion could draw attention away from building credit unions as sustainable co-operative businesses through serving a wide and economically diverse membership. Detailed analysis of the costs involved in serving members with low-value loans was undertaken in two staff-run credit unions. In Credit Union A, on a £300 loan, even adopting the very strictest of marginal costing models, the surplus ranged from a loss of £39.60 to, in the best possible case based on monthly electronic payments, to a surplus of £20.36. If fully recovered costs were considered then it was not possible to recover the costs incurred in raising and administering the loan. In Credit Union B, the loss on a typical £300 loan was £30.41.

The impact of Government policy

66% of respondents said government policy had assisted credit union growth. This rose to 88% among work-based credit unions.

61% of all, and 82% of work-based, credit unions, said regulation had assisted growth.

69% of respondents said the financial inclusion strategy had assisted growth. This rose to 71% of live or work credit unions.

61% of live or work credit unions said the permission to charge up to 26.82% APR had been helpful. 43% of residential credit unions agreed.

Financial Inclusion Growth Fund

At the time of the survey, 86 credit unions were delivering the DWP Growth Fund³. Loans made by credit unions accounted for 91% of all Growth Fund loans made and 89% of the money loaned.

76% of respondents, delivering the Growth Fund, said it had assisted the growth of their credit union.

A vision for the future

Credit unions were asked to comment on a vision for the future. This was:

“If credit unions are to be effective long-term they will have to offer a range of financial products and services to suit different segments of the market.

This can only come about through the creation of a modernised credit union brand recognised as mutual and local, and as offering quality financial services to all.

It will depend on the leadership and the good governance of boards of directors and on the managerial skills of competent staff. It would be assisted through large-scale collaboration to offer products and services through centralised back office systems and delivery networks”.

70% of live or work credit unions agreed with the statement, with 33% expressing a strong agreement. Agreement was lower, 58%, among work-based credit unions. Only 44% of residential credit unions agreed.

Recommendations

The question of credit union development is not so much, as in 1998, about what needs to be done, but rather how it is to be achieved. With so much positive change and growth in the last ten years, and a new legislative framework to look forward to, the future more than ever depends on the leadership and skills of boards of directors and of executive managers.

The research concluded that:

- *The priority for many credit unions is to continue to grow, developing a diverse membership, mobilising savings and achieving the financial efficiencies that will lead to a sustainable business.*
- *Central to this is the need for many to introduce a range of updated financial products and services to meet the needs of the modern consumer.*
- *The small size of many credit unions is a factor affecting their ability to expand products and services. In an increasingly challenging financial market, credit unions need to pursue greater back-office and front-office collaboration. This will enable economies of scale and greater innovation yet allow credit unions to continue to provide a quality, local and mutual service.*
- *Boards of directors need to demonstrate good governance and find the leadership to take their credit union to the next level.*
- *Increasing attention needs to be given to the recruitment and professional development of senior and middle managers.*
- *Government interventions focused on financial inclusion have been both successful and welcome. However future initiatives need to recognise that the route to serving more excluded people is through strengthening the credit union and building a broad based institution.*

³ Established by UK Government to increase the availability of affordable personal loans via third sector (not-for-profit) lenders