Growing Credit Unions in the West Midlands – the case for restructuring

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Abstract

This paper explores current issues in the modernisation of British credit unions. It describes and analyses the challenges and dilemmas they face as they endeavour to increase their market share and to serve a diverse membership with attractive financial products and services. The paper makes the case for a radical financial and organisational restructuring of credit unions and argues that, they are only going to grow as viable and relevant financial institutions in Britain, if they adopt robust market oriented and commercial principles. The paper analyses the implementation of these principles within a credit union strengthening project in the West Midlands.

1. Credit unions in the West Midlands

The rate of growth of West Midlands credit unions is not dissimilar to that of credit unions generally in Britain. From 1995 to 2001, non-employee credit unions in the region grew on average at a rate of only 14 members per year. At year end 2001, the 72 credit unions in the region had a combined membership of 25,080 adults representing a penetration rate of less than 0.5 per cent of the population. The average number of members per credit union was 381 and the average total asset value was £233,000. Just ten credit unions accounted for 59 per cent of the total membership and 79 per cent of total asset value. The largest credit union, operating solely in the West Midlands, was Citysave, an employee based credit union based in Birmingham, with around 5,000 members and £3 million in assets. In general, throughout the West Midlands, credit unions found it difficult to attract new members and to build assets.

Lack of growth has major consequences for credit unions. Without sufficient members to generate savings and assets, they find it difficult to establish themselves as effective and sustainable financial institutions. Low membership results in a lack of financial and organisational strength and an inability to develop the capacity to offer a range of quality financial services at affordable costs. Without this capacity, credit unions cannot fulfil their potential, recognised by UK central and local government (HM Treasury 1999a and b; Local Government Association 2001), to combat financial exclusion and to build wealth in communities.

In recent years, academic researchers have endeavoured to identify the reasons why credit unions have not grown in Britain as significantly as they have done in other countries (Jones 1999; Donnelly and Haggett 1997; Conaty and Mayo 1997). Poor legislation and regulation, ineffective development models, fragmented trade associations have all been identified as relevant factors (Jones 1999). People often agree on what the problem is, they are less sure about the means and methods of bringing about change. In order to explore the dynamics of transformation, Advantage West Midlands (the Regional Development Agency), the West Midlands Social Enterprise Partnership and the Countryside Agency have funded an action research project aimed at enabling credit unions to rethink their management and organisation and to take actions designed to maximise growth. The project, *Creating Wealth in the West Midlands through Sustainable Credit Unions,* began in December 2002 and will operate until March 2005. The learning generated through the action research will inform the development of credit unions regionally and nationally.

2. The problem explored

The majority of West Midlands credit unions arose out of a traditional social development model which has parallels throughout the credit union world (Richardson 2000b; Jones 2001; 2002). This model was based on an understanding of credit unions as relatively small, local, volunteer-run community organisations established primarily to provide low cost loans to poor people who had no access to other financial institutions. High priority was given to community involvement, member participation and the social and personal education of volunteers.

The overall impact of the social development model was to leave many credit unions financially weak, with little organisational capacity and with an ongoing dependence on external grants and subsidies. Member service was often poor, with many credit unions operating out of unsuitable premises for just a few hours a week (Jones 1999). Traditional model credit unions were not built for growth. In fact, growth was often seen as a threat as it both compromised the community-oriented culture of the organisation and its manageability by volunteer groups.

The financial impact of the traditional model has resulted in an inability to build institutional capital and a lack of responsiveness in providing market rates of return on savings and competitive interest rates on higher value loans.

A number of studies have been carried out on the impact of the traditional development model within credit union movements throughout the world, particularly in Latin America, (Branch 1993; Richardson 2000b; Jones 2002). The finding of these studies has been that the social development model has been unable to build viable financial institutions and, more often than not, has resulted in the establishment of grant dependent, financially weak credit unions unable to mobilise savings and generate income.

In some countries, credit unions operated more as channels of external donor funds to the poor rather than self-sufficient financial co-operatives (Jones 2002). Over time, external dependency on donor funds undermined self-sufficiency, and effective performance, and compromised long-term sustainable development. Similar organisational dynamics have been recognised as existent within the British credit union movement (McKillop and Wilson 2003).

Richardson and Lennon (2001) have argued that the poor performance of traditional model credit unions has led many microfinance professionals in developing countries to abandon credit unions as viable and efficient mechanisms for responding to the needs of the poor. Similarly, in Britain, some academics have argued for new forms of community development finance initiatives on the grounds that credit unions are inevitably limited in their potential to serve low income communities (Dayson, Paterson and Conaty 2001).

3. The case for restructuring

Since 1999, there has been a recognition within the British credit union movement that adherence to the traditional model of development has restricted credit union growth (Jones 1999). This recognition has been reflected in ABCUL's[1] promotion of more business oriented approaches to development which have received the support both of Government and of municipal authorities (HM Treasury 1999a, 1999b; Local Government Authority 2001). However, international case studies have demonstrated that the transformation of traditionally organised credit unions into stable and effective financial institutions entails not merely the adoption of basic business practices but a radical financial, organisational and operational restructuring (Arbuckle 1994; Richardson 2000a, 2000b). Wherever they operate, the independence and viability of credit unions depends on their ability to generate sufficient income to cover operating expenses, build reserves and pay attractive dividends on savings. Given their existing mode of operation, this is what many British credit unions have found difficult, if not impossible, to achieve. Traditionally organised credit unions have inevitably remained undercapitalised, dependent on external subsidies and without the capacity to expand.

The restructuring required to develop credit unions as stable financial institutions has become known as new model credit union development (Jones 2001), understood as a major correction in the management of credit unions so that they are better able to serve the poor and financially excluded. New model development is based on seven 'doctrines of success' (Richardson 2000a). Simply put, these are serving the financial needs of the population at large, maximising savings, portfolio diversification, operating efficiency, financial discipline, self-governance and assimilation. These doctrines of success are in marked contrast to the operation of a traditional model credit union that focuses solely on serving the poor, is borrower oriented and offers a limited range of products within the alternative lending market.

The West Midlands project aims to assist credit unions to restructure their organisation and operations in a way that prioritises financial discipline, economic strength, professionalism and quality in financial services. It became clear early on in the project that the required restructuring would touch on all aspects of credit union organisation simultaneously. It introduces business and market oriented practices, modernised lending procedures, and a new financial structure as well as challenging directors and staff to rethink governance and management in their totality. New model development is a methodology that is based on the fundamental insight that credit unions can only serve members effectively, particularly the poor and financially excluded, if they are developed as businesses able to compete successfully within the same market as other financial providers.

Whether or not credit unions in the West Midlands are able to expand and achieve significant economic growth is yet to be determined. However, international experience of the modernisation and strengthening of credit unions and credit co-operatives is positive. McDonald (2000) notes how strengthened credit unions in Latin America are outperforming banks and other microfinance institutions as efficient and profitable organisations.

4. Project methodology

The West Midlands Credit Union Project is managed by ABCUL and is delivered by a diverse project team including business consultants drawn from outside the credit union movement. The careful selection of the team reflects the project's aim of introducing credit unions to modernised business practices and to commercial operating standards not always present within the credit union world itself. Research both in Latin America (Richardson 2000b) and in Britain (Jones 1999) revealed that a business culture does not always fit easily with the socially-oriented ethos of traditional credit union development. It was not long into the project, for example, some of the team became aware that principles that they regarded as aspects of a well-run business, could appear to some activists as undermining credit union philosophy.

For volunteers and paid staff who became involved in credit unions for social and ethical reasons, beginning to think commercially is demanding. Project staff found that introducing a business approach could not be brought about by a pragmatic reform of business practices alone. It demanded, on the part of project participants, a radical cultural shift in the way they thought about the fundamental purpose of credit unions themselves. For many project participants this was not easy to accept and, in some places, it even provoked resistance.

There are a number of inter-related and interlocking strands to the West Midland project. However, central to its methodology is a focus on the business development of a number of selected Beacon credit unions which have both the potential and the drive to expand. Out of the experience of developing these credit unions, good practice is communicated, or 'cascaded', to all credit unions in the region through a series of publications, workshops, seminars and technical assistance where appropriate. The project also takes direct corrective action within the most vulnerable credit unions if it is deemed and agreed as necessary.

5. Building beacon credit unions

The methodology of focusing on the development of Beacon credit unions arises out of the World Council of Credit Union's (WOCCU) experience in Latin America where it was found that overall improvements in a credit union movement owe much to the creation of an identifiable number of effective and successful credit unions that set standards for other credit unions in the region. In fact, key design elements of the West Midlands project are based on the institutional development programmes operated by WOCCU throughout the world (Richardson, Lennon, and Branch 1993; Arbuckle and Adams 2000).

All WOCCU projects start with a credit union assessment, or diagnostic, in order to identify the credit unions which are best suited to participate in a development programme (Branch and Cifuentes 2001). A rigorous analysis assesses the market and economic viability of the credit union, its financial condition, the adequacy of its management systems, policies and internal controls, its reserve levels, its loan portfolio and delinquency, and operational efficiency. Only those credit unions that demonstrate market potential and organisational capacity are selected as project participants. The selection of the West Midlands Beacon credit unions depended equally on a 'health check' to identify the management, organisational and financial areas where the performance of the credit union could be improved. Selection as a Beacon depended on a reasonable rate of historical growth, on the expertise of the credit union in controlling its business operation and on the potential and ambition of the credit union to achieve a level of growth required for its long term viability as a financial institution.

However, given the level of growth in the region, the identification of credit unions to participate as Beacons did not prove easy. The project set out to recruit four or five Beacon credit unions that had the market potential, leadership and organisational capacity to grow their membership and assets during the period of the project. Twelve credit unions applied but, in fact, the project was only able to identify three that clearly had a track record of growth. In addition, it was able to recruit a relatively new rural credit union which, although still relatively small, had the ambition and the drive to expand. To these four, was added a new credit union venture, the potential of which was uncertain, but which involved a cluster of three small credit unions aspiring to grow through amalgamation.

Internationally, the rigour of a WOCCU project selection process is assisted by a significant demand from credit unions to participate in a programme. They perceive tangible benefits from participation and are ready to compete for project inclusion. In the West Midlands, some credit unions were more reticent and had to be convinced of the benefits of project participation by the project team. Arguably, this introduced a certain weakness in the West Midlands project as all processes of change depend ultimately on the motivation and drive of participants themselves to bring about change. Credit unions participating in WOCCU projects must commit themselves to active participation in the programme through a formal participation contract (Branch and Cifuentes 2001) This contract specifies the obligations of both the project and the credit union, and includes penalties for non-compliance. Participating credit unions must meet set financial and operational targets and failure to do so can mean expulsion from the project. In the West Midlands no such contract exists and, even though the project identifies individual credit union goals, participation remains open, voluntary and ultimately not dependent on entrepreneurial drive and performance. Nevertheless, only those credit unions that could demonstrate commitment to new model development, to growth and to active engagement with the process were selected for entry into the programme.

The five credit unions selected for Beacon status within the West Midlands project were:

- Citysave Credit Union Ltd, Birmingham
  - Citysave was registered as a credit union in 1988 and serves the employees of Birmingham City Council and their relatives. It is a financially self-sustaining credit union. At year end 2002, Citysave had 4,886 adult members out of an estimated common bond of 50,000 plus with savings of £2.78 million. At the start of the project, membership was relatively static and income was insufficient to build capital reserves and to pay a market-rate dividend. In order to maximise income and expand its membership it voted at its 2003 AGM to investigate the expansion of the common bond to include everyone who lives or works in the city of Birmingham.
- Walsave Credit Union Ltd, Walsall
  - Walsave was registered in 1996 and serves all those who live and work in within the borough of Walsall. Originally, Walsave served only the employees of Walsall Council but over the last five years it has merged with three community based credit unions and two steering groups. At year end 2002, it had 2,848 members out of a common bond of 305,000 and assets of £1 million. 75 per cent of its members were still employees of the Council. With the support of a European Objective 2 grant of £500,000, Walsave is expanding its operations and moving into new centrally located premises. Walsave faces the challenge of building its membership and income in order to free itself from dependence on external funding. It needs to build capital reserves, 2.5 per cent at year end 2002, as well as loan loss reserves and to generate funds to pay a market-rate on savings. Walsave also faces the challenge of integrating its constituent credit unions into the larger organisation by combating fragmentation and promoting the active participation of community members.

- Fairshare Credit Union Ltd, Telford
  - Fairshare was formed through the amalgamation in 2000 of Telford and Wrekin Council Credit Union, which served municipal employees, and three small community credit unions in the area. At year end 2002, Fairshare had 2373 members, out of a common bond of 137,000 adults, and assets of £1.2 million. Fairshare employs a staff team of 5.3 full-time equivalent workers and operates a number of branches in the former community credit union collection points. It is dependent on external subsidy from the local authority which will disappear at year end 2005. There is evident pressure to expand and to rationalise the business and an ambitious business and marketing plan is already in place.
- Worcestershire Credit Union, Worcestershire
  - Worcester Credit Union does not yet exist. Three community credit unions have come together to form a potential Beacon through a process of amalgamation. The three community credit unions are Worcester Black Pear Credit Union, which had 475 members and £135k in assets at year end 2002, Redditch Credit Union, which had 900 members and £200k in assets, and Bromsgrove and District Credit Union, with 80 members and approximately £30k in assets. These credit unions are mostly volunteer run, but Worcester Black Pear and Redditch do currently have external financial support to employ managers. All three credit unions are undercapitalised and face an immense challenge to create a credit union to serve the whole of the country of Worcestershire.
- Just Credit Union Ltd, Shropshire
  - Just Credit Union serves everyone who lives or works in the county of Shropshire. This is a rural area of 1,234 square miles with an adult population of 176,500 people. Just was registered in 2001 and has, at year end 2002, 352 members with shares of £82k. About 70 per cent of the membership are employees of the County Council. Just receives external subsidy from the County Council to employ staff and operate its main office. As a new credit union, undercapitalised and dependent on external support, Just faces the challenge of growing the credit union effectively throughout the county.

6. The commercialisation of credit unions

Most British credit unions have been product led as opposed to customer and market led which is the standard approach for modern UK business. They have offered basic savings and loans products, with identical conditions, to all sections of the market. Growth figures demonstrate that such an approach has not attracted people in sufficient numbers into credit union membership. Even within low income communities, research has revealed that credit unions have not always been competitive enough to attract the people who, arguably, need them the most (Jones 2001a). Credit unions are rarely successful in significantly competing with high interest alternative and sub-prime lenders which aggressively respond to market led circumstances.

The West Midlands project seeks to encourage credit unions to re-think their position in the market and to develop more customer-oriented approaches to their business. The aim is to offer different and diverse groups of people the sorts of financial products and services they want. It endeavours to assist credit unions to attract people into membership by the quality of the products and service on offer rather than by convincing them to share a passion for a pre-existing credit union ideology and accept compromises in product suitability, accessibility and quality of service. Frank (2002) has written, in reference to non-profits, how activists often create enterprises based on a mission which, because unrelated to the market, fail to realise their objectives and potential. Historically sections of the co-operative sector have certainly suffered from a failure to operate commercially leading to decline in retail and other co-operatives throughout the country. It is not without significance that the Co-operative Commission Report (2001) identified the co-operative mission as the building of a “commercially successful family of businesses that offers a clear co-operative advantage”. Writers such as Sparks (2002) have pointed, however, to the level of the challenge this presents co-operatives operating in a fiercely competitive external environment.

Operating commercially presents credit

unions with a particularly pressing challenge as it not only questions ideology but calls for radical change in policy, practice and organisational structure. Developing credit unions as effective and sustainable new model financial institutions has a myriad of consequences in terms of financial restructuring and discipline, operating efficiency, savings mobilisation, product diversification and the expansion of new market niches (Richardson 2001). Beacon credit union participants, who certainly accept the need to modernise and grow, have found aspects of commercialisation difficult to harmonise with their traditional understanding of credit union ethos and practice. The notion of market segmentation, for example, seemed to some to compromise the principles of equality on which they felt the credit union movement was built.

Resistance to the commercialisation of credit unions exists within certain sections of the British credit union movement and has had its influence within the West Midlands. Brown, Conaty and Mayo (2003) are sceptical of beacon credit union development on the grounds that

> success indicators are largely based on passing the breakeven point on the balance sheet, so that social objectives do not form an explicit component of the new model.

The National Association of Credit Union Development Workers has maintained too that the new model focus on economic reality undermines credit union identity as a community and socially driven organisation (National Association of Credit Union Workers 2002). Brown further argues that commercialisation de facto involves the levying of unacceptably high interest rates on loans to the less well off (cited in Urwin 2003). These concerns reflect, to a certain extent, a fear of the 'degeneration thesis' (Cornforth 1988) that has surfaced regularly in the history of the co-operative movement and which maintains that, in their search for success, co-operatives tend to adopt the same practices as capitalist businesses and, in so doing, lose their particularity and distinctiveness. This debate between 'business-minded institutionalists' and 'social-minded welfarists' (Richardson 2001) exists throughout the microfinance industry and, certainly, WOCCU has encountered resistance throughout the world to the development of credit unions that endeavour to operate to commercial standards (Jones 2002).

Yet the argument for commercialisation remains a compelling one. Richardson and Lennon (2001) argue that the strengthening of credit unions using a commercially oriented operating methodology has revolutionised credit unions throughout the world and "transformed them into highly efficient microfinance institutions". These restructured institutions serve low and moderate income groups alike. Not only does operating commercially ensure the financial strength of the organisation and its independence from external subsidy, it enables a credit union to offer the kind of quality products and services that low income people want.

The Beacon programme is an action-oriented learning programme in which participants are encouraged to share and reflect upon their experience, to tackle common problems, to test out solutions and to learn through a process of action and reflection in a way that informs the development of their credit unions as viable and effective financial institutions. Central to this programme is developing the ability to make commercial decisions and to test out their impact on both the organisation itself and on the service offered to members. The challenge is to achieve financial sustainability through commercial activity whilst, at the same time, ensuring an expanded and effective service to low income communities.

6.1. Financial restructuring

In countries where credit unions are established, research has shown that the principal reason most people become members is, first, to have a dependable place to save and, secondly, to have ready access to a source of credit (Scott 1992). In the West Midlands, credit unions certainly attract savers. However, for the most part, many members tend to save a relatively moderate amount in the credit union whilst keeping most of their savings elsewhere. For credit unions, the ability to attract the significant savings of large numbers of members is the ultimate test of commercialisation (Klaehn, Evans and Branch 2003). For not only does the credit union have to inspire trust in a secure and safe financial institution, it has to be able to offer an accessible service and pay a competitive return on savings. To do this depends on rigorous adherence to market-based disciplines.

At the beginning of the project, most Beacon credit unions found it difficult to pay commercial rates on savings and to offer a service where deposits could be made and withdrawn on demand. To be able to do this, new model methodology suggests two important changes to the financial structure of the credit union. First, it advises planning in advance to pay a dividend on savings rather than wait until year end and declaring a dividend out of a remaining surplus. Secondly, it advises severing the link between loans and savings, a linkage which traditionally has prevented any borrower withdrawing their savings if the loan outstanding was higher than their savings' balance. These two changes demand that credit unions change the way they do business. Planning to pay a dividend demands much greater financial discipline and also the introduction of accruals based accounting. Severing the link between savings and loans entails a new and more rigorous approach to credit assessment and lending. Beacon credit unions have found both these changes to be challenging. A number have made progress in breaking the link between savings and loans, but, as yet, planning in advance to declare a dividend on savings is proving difficult.

Severing the link between savings and loans entails a radical reform of credit administration systems and the introduction of risk based credit analysis based on a member's capacity to repay. It is neither a legal nor a regulatory requirement for a member to undertake a period of savings prior to being granted a loan or to restrict loan granting to a multiple of shares held by the member. Yet this has been a particularly difficult issue to tackle as it challenges some long held traditional beliefs about credit union services. Despite the adoption of modernised credit assessment procedures in a number of Beacons, resistance to change remains. Project staff have actively sought to promote the use of ALERT, ABCUL's credit scoring tool, in response to a need for objective credit assessment.

Restructuring depends on policy changes in a range of interlinked areas and aspects of the financial management of the credit union. This was probably one of the earliest learning outcomes of the Beacon project. Advances cannot depend on changes in one or two areas alone. Reforms are demanded in financial discipline, meeting prudential standards, increased operating efficiency, savings mobilisation though attractive dividend rates, credit analysis, loan granting and product diversification (Richardson and Lennon 2001).

Greater transparency in accounting itself is central to new model methodology. Provisioning for bad debts and delinquency is a major point of the process of reform. This was a particular challenge for some credit unions in the Beacon programme. There can be a tendency in credit unions to look at bad debts in ways that allow them not to appear as high as they really are. The same point can be made for the approach to grant accounting and the impact of external subsidies on the credit union balance sheet.

A key area of structural change is the approach to maximising income to build capital reserves in the credit union. Strong reserves are key to strong credit unions. Several of the participating credit unions commenced the programme with low capital reserves but through a process of income generation have been able to strengthen their capital base significantly. Three credit unions now have reserves of 5 per cent, low by international standards, but which allows them to cross the FSA threshold and make larger loans and amass greater savings. But this is not easy. In at least one case, building reserves has meant that the credit union has been unable to pay a dividend on savings. The dilemma is that this is disadvantageous to savings generation with consequent loss on funds for lending, however, it is necessary in order to ensure the long term safety of members' savings.

6.2. The significance of PEARLS

The key methodological tool used within the Beacon programme is the PEARLS financial monitoring system (Richardson 2001). Originally developed in Latin America by WOCCU as a means to evaluate the performance of credit unions, PEARLS is a sophisticated financial management tool capable of measuring key areas of credit union operations, both in terms of financial structure and growth. It enables credit unions to identify problems and thus, potentially, find solutions for institutional deficiencies. It is linked methodologically to business planning and enables credit unions to plan and set goals for the future.

PEARLS sets standards for credit unions in the following areas:

- **P**rotection – refers to the adequacy of loan loss provisions.
- **E**ffective financial structure – measures loans, assets, savings, shares and reserves as a proportion of total Assets.
- **A**sset quality - measures loan delinquency and non earning assets.
- **R**ates of Return and Costs - measures rates of return.
- **L**iquidity – measures liquid investments and reserves against withdrawal deposits.
- **S**igns of growth – measures the growth rates of total assets, loans, deposits, shares, capital reserves and membership.

For each indicator, within PEARLS, target ratios are identified by which individual credit unions measure institutional strength, economic viability and growth. Some commentators have claimed that PEARLS overly stresses objective measurements, whereas other ratio analysis tools, such as CAMEL, allow for a much greater degree of subjective judgment on management quality and capability. (van Greuning, Gallardo and Randhawa 1998).

The importance of PEARLS within the Beacon programme turns on the fact that ratio analysis reveals interconnected issues within the internal financial and organisational structure of the credit union. It reveals problems, it does not solve them. In the programme seminars, solutions have to be sought through dialogue and discussion within which assumptions about credit union operations are challenged and explored. The dialogue facilitated by PEARLS aims to raise the awareness of key financial management issues in the minds of the participants. It promotes a sense of urgency, fundamental to kick-starting any process of change (Kotter 1996). An awareness of a steady decline of institutional capital, for example, related perhaps to a low return on loans made, has the effect of moving individuals to want to take corrective action in their credit unions. PEARLS endeavours to promote a changed mindset about credit union management.

Within the programme seminars, there is already evidence that an analysis of financial ratios is engaging people to think and to consider making fundamental changes within their credit unions. Citysave is considering, for example, modernising its loan policy on the basis of an analysis of the necessity to increase income to build capital reserves and pay a dividend. A 0.5 per cent dividend rate, payable on savings in 2002, is not attractive to members and potential members. Interconnected ratio analysis makes people think and question the reasons how and why the credit union is currently performing at its current rate. An important learning outcome has been that ratio analysis is not just a financial exercise distinct from the main business of running a credit union. PEARLS presents participants with a vision and a mission based on how a successful new model credit union operates and can operate in a competitive financial market. PEARLS reveals both crises and opportunities to participants, the key elements that stimulate change in an organisation.

The introduction of PEARLS in the Beacon seminars was not always easy. The participative approach promoted in the seminars, in which people engaged in a theoretical and practical discussion of the issues revealed through ratio analysis, did not engage all participants equally. Clearly one issue was learning style. Not all participants were comfortable with an open, action-oriented style of approach. More significant was an initial lack of technical competence in financial management among some participants. In Britain, credit unions have often been regarded as relatively straightforward community organisations, which need little more to operate than volunteers' good will and external funding. Given this background, it is understandable that some participants tended to consider that an analysis of financial ratios had little real consequence to the effective development of a credit union. This is significantly at odds with standard business practice in which management through observance of key performance indicators (KPIs) is the established norm.

Commercially the critical application of financial management ratios enforces an awareness and accountability for performance as a necessary component of success. For some, the prospect of observable accountability was unwelcome and it seemed that participants failed to make the link between ratio analysis and the practical implications of this analysis within the operations of the credit union. For a few, there was even scepticism of the relevance of PEARLS ratio analysis at all.

The challenge for the project team was to ensure that those having difficulty seeing the relevance of PEARLS seminars received additional support. It is clear that there needs to be, as one project worker noted, "much more hand holding of credit unions through the process". This is fundamental to encouraging people to think differently about credit union management. Progressively, more participants were able to use PEARLS effectively and its methodology was increasingly seen by boards of directors as essential to informed business planning. The full implications of PEARLS analysis are clearly not yet fully worked through in all participating credit unions but progress is being made. The process of change takes time particularly within credit unions which are operationally under pressure.

6.3. Organisational development

New model development depends on credit unions offering convenient and quality products and services that meet or exceed their members' expectations. Recent research in the US has indicated that the most important factor in credit union success is the quality of member services (Udell 2003). Traditionally, British credit unions have offered a limited range of products from often poorly located and inaccessible premises. Accelerated growth occurs when credit unions adopt a market led approach requiring that they offer a range of products and services to meet the diverse needs of their membership and when they significantly improve their performance and service delivery capacity (Sasuna 2003).

The Beacon project has focused on assisting credit unions to enhance their image. Both Fairshare and Worcester Black Pear have opened new premises which aim to offer a professional image and attract new savers. This has involved technical training for staff and volunteers both in member care and in the development of a modern organisation. In some cases, as with Fairshare, this has involved a major organisational restructuring of the credit union. Some poorly performing locations were closed whilst the service at the central location was improved and expanded. In the rural area of Shropshire where the opening of branches is not cost effective, new electronic ways of accessing the credit union are being piloted through the project. Just Credit Union has recently offered all its members throughout rural areas the opportunity to access the credit union with electronic cards through post offices and other shops.

Fairshare in Telford, Walsave in Walsall and Just in Shropshire are all West Midlands credit unions that are beginning to develop a greater range of products now, for the most part, they have separated lending from saving. More efficient credit administration procedures mean that applications are dealt with within days, or even instantly, by trained loan officers. Interviews are only required in exceptional cases. Revolving lines of credit are being considered for some established members and both Walsave and Fairshare have experimented in lowering interest rates for larger loans.

Lending on the basis of an ability to repay demands the introduction of more systematic and depersonalised credit granting procedures. It entails a greater reliance on objective data and documentation, on the introduction of forms of credit scoring techniques and on the greater use of credit reference agencies in addition to character assessment. While commercially essential for a business intent on reaching out to the widest need, this is challenging for credit unions that have traditionally regarded such objective systems as compromising a commitment to the open acceptance of the member.

6.4. The development of financial markets

The manager of one of the smaller participating credit unions remarked at one seminar, "the most we ever did about marketing was put up a poster or two. Marketing did not feature as an important priority". In fact, most people involved in credit unions gave little consideration to financial markets. To the extent that they did, they believed in the "credit push" paradigm (Arbuckle 1994). The posters and leaflets were all about loan sharks and cheap credit. On the contrary, new model methodology prioritises marketing as part of its move to a more commercial model of business. It prioritises not a credit but a savings paradigm.

A number of Beacon credit unions have, as part of the project, undertaken professional market research in order to ascertain who credit unions are serving and who they are not. It has revealed some interesting results. It has shown how a number of credit unions are earning most of their income from a small number of higher income members whilst serving large numbers of lower income small savers and borrowers. It has become clear to participants that it is difficult, if not impossible, to develop credit unions if the main lending products are solely small loans to low income people. New model methodology demands a much greater loan diversification in order to spread fixed costs over larger loan volumes in order to generate income. Market research has revealed the variety of high quality financial products that have to be available for different segments of the market.

To develop a much wider loan portfolio, funds must be generated by mobilising the savings of members. This is the key focus of new model organisational development and depends ultimately on credit unions paying market rates of interest on savings. The majority of Beacon credit unions are now endeavouring to pay dividends. This means that all members, savers and borrowers alike, receive benefits from their involvement in the credit union. In a traditional credit union, offering cheap loans and no dividend meant that borrowers benefited from the philanthropy of savers. In reality, however, the majority of savings deposits are invested only to obtain a loan in such borrower dominated credit unions.

Market segmentation, product diversification, unique selling propositions and corporate branding have all become standard terminology in the seminars conducted on the project. By design, the project has employed external professional marketing experts to bring a knowledge about marketing often absent in the traditional credit union movement.

There are already some notable successes with credit unions moving into new market niches. Fairshare identified a new market among housing association staff in the county and now offers below rate car loans to staff members. Walsave has exploited an opportunity to serve members of a football supporters' club in the town. There is a greater interest in developing the image and the products of the credit union in order to attract people to the credit union. Credit unions were traditionally just open to those who knew about them and shared their values. Typically their focus was on marketing to existing members and excluded any meaningful attempt to acquire new member 'customers'. Modernised credit unions realise they have to sell their unique brand and ensure the public see the quality of services on offer. For British credit unions, this is a sea change in thinking and attitude.

7. Leading change in credit union development

The Beacon project has demonstrated that where both instrumental and charismatic leadership are present, growth happens in a credit union. Identifying and finding leaders within the Beacon credit unions that have the energy and entrepreneurial drive to accept the challenge of change has been a key task for the project team. For this reason, an important focus has been on involving volunteer members of the board of directors on the programme as well as the staff. Internationally, the role of the board in leading change has been recognised as crucial to credit union success (Arbuckle 1994; Branch and Cifuentes 2001).

Spear (2003) argues that in co-operatives it is often the managers that are the most powerful and influential rather than the boards. Boards, he suggests, may exercise insufficient control due to little or no financial stake in the enterprise. Branch and Baker (2000) suggest a similar point. They maintain that it is only when there are net savers on a board that effective pressure is brought to bear for proper financial management and prudent governance. These savers have a real stake in the credit union and seek, through commercial activity, a return of those savings. However, in most Beacon credit unions, the bulk of directors' real savings are probably in other financial institutions. Arguably, this leaves credit union boards weakened as, following Spear, board members realise that they can participate in benefits without participating in real control

Without director leadership and control, it is very difficult to make significant progress. Where the project has seen real success is when the board of directors of the credit union thinks about credit union development in commercial terms and begins to take action. Citysave credit union noticeably changed when its board, inspired by the PEARLS methodology, adopted a new vision and a sense of leadership within the organisation. Cornforth (2003) offers a multi-paradigm perspective to highlight the paradoxes, ambiguities and tensions boards face in practice. One such tension is between board members who act as representatives of the community and those who act as experts, or leaders, whose mission is to drive forward the performance of the organisation. Credit unions in transition certainly need strategists, people who have expertise and experience and who can work with the staff to improve decision-making and to take appropriate action.

However, change is not easy for any credit union. It may be particularly difficult for co-operatives where many people claim an equal voice in decision making process (Landry et al 1985). There are always long lists of reasons why change in any one particular credit union is especially difficult (Kotter 1996). Directors and staff may be faced with a lack of capital investment, limited organisational capacity and historic non-productive policies, practices and procedures. They may also inhabit an organisational culture that resists making commercially oriented decisions. Despite these difficulties, some Beacon credit unions have been able to implement significant changes so long as they had board leaders and staff with imagination, drive and an ability to face and manage risk.

Change often depends on some kind of trigger, a pressure for change which arises from the realisation that current policies, procedures or other aspects of the organisation's structure are no longer appropriate or effective. The PEARLS seminars have been designed precisely to provide triggers for change. Leaders among the participants recognise the trigger and realise the urgency of bringing about change in policy or procedures. The Fairshare directors were quick to implement changes in lending policies as soon as they saw the relationship between lending policies and income generation. Fairshare feels a sense of urgency to maximise income to ensure the continued operations of the credit union once external funding terminates in 2005.

This sense of urgency, which is the prerequisite of effective change, can be compromised, however, in credit unions for several reasons. Some of the key reasons surfacing within the Beacon programme include:

- The availability and impact of external subsidy. Although undoubtedly important in providing the investment for strategic change, substantial grant aid can engender complacency and undermine entrepreneurial initiative.
- The alternative scenario is also true - a lack of capital investment and resources undermines the capacity for change.
- A realisation of the enormity of the change being proposed. The move to a new model approach entails such a radically different understanding of the purpose and mission of credit unions that the magnitude of the change can undermine a resolve to see it through.
- An inability to see the interconnectedness of policies, procedures, systems and economic results. This undermines the commitment to take action in one area as it is not seen to be related to an area of real concern.
- The time for directors and managers to consult with each other and address current circumstances and issues. Opportunity in this regard is constrained by the availability of directors for strategic or tactical development over and above the demands of the operation and their statutory duties.

Finding leaders who share a sense of urgency and who have the drive to see it through has not always been easy. Many participants came to credit unions out of a social interest in their communities and would not normally be involved in, or lead, a financial institution. Credit union directors do not always have the necessary aptitude for sales and marketing and their experience may not be particularly relevant to the needs of a commercial business. However when the importance of expertise, in marketing and accounting, is recognised and accepted, and linked to leadership and good governance, impressive results can be achieved.

8. Creating a vision

Central to success and growth is a vision of the purpose and potential of credit unions. Inspiring a shared vision and personally communicating the future direction of credit unions has been a central role of the project. Project staff have worked with boards of directors and endeavoured to give clear and honest answers to the what, why and how questions of turning vision into reality. What has been key to success has been, first, the way in which some participants have seen the vision as emotionally compelling and, secondly, understood, how they could contribute to achieving its realisation in practice. (Jackson 1997)

However, credit union purpose has been a contested issue within the West Midlands. People see credit union rationale and function differently and, consequently, have different visions around their future development. This presents a challenge to Beacon credit unions and to the project. There seem to be at least five understandings of credit union purposes identifiable from the contributions of Beacon credit union participants.

The five purposes are:

1. The social purpose – in this view, credit unions are seen as organised primarily for the poor and deserving of ongoing public subsidy to ensure that they can serve financially excluded groups. Brown, Conaty and Mayo (2003) note, for example, that the notion of a 'poor person's bank' can effectively describe the credit union purpose.
2. The charitable purpose – in this view, credit unions are also seen to have a social purpose but not just to serve the poor but all disadvantaged groups within society. The main focus of this understanding is the development of credit union services closely in liaison with social and voluntary organisations. The need for external subsidy is accepted in this view but, as with major charitable organisations, there is an acknowledgment that credit unions do need to be organised and managed as businesses.
3. The local community purpose – in this view, credit unions are organised by small groups of people for a limited number of people in a neighbourhood or on a housing estate. The focus of this view is involvement in local community networks and organisations. The financial purpose of the credit union remains but more important is the social and educational development of volunteers and their active involvement in the community.
4. The public sector purpose – in this view, credit unions are regarded as extensions of local authority services either for their own employees or for residents within the community. People adopting this view do consider that credit unions have a responsibility to become self-sustaining businesses but, in the case of difficulties, it is believed that the local authority ultimately has to accept responsibility for the safety and soundness of the credit union.
5. The business purpose – this is the new model customer approach in which credit unions are understood as having to succeed first as market-oriented and commercial businesses in order that first tier social and economic purposes may be achieved.

It is clear that the first four purposes sit uncomfortably with a vision of credit union development that focuses on the necessity of facing market and commercial reality. People possessing any of the first four understandings of purpose, even if professionally skilled or qualified, do not readily respond to market-oriented or commercial imperatives and find it difficult to share a vision that entails delivery of business objectives. The social, charitable, local community or public sector understanding of credit unions can be so ingrained in the thinking of participants that there is a block to thinking commercially at all. The result is a lack of drive to establish a credit union as a viable financial institution. One of the project team members noted,

> Credit unions do not seem to be asking the questions that the commercial world would see as obvious. In business organisations, the process of change would mean that many of the staff would have to change jobs or leave. This does not appear to be an option in the credit union movement, which is entirely reliant on people changing their personal vision, views and understanding.

Out of the varying perspectives, the project team endeavour to create a vision that all participants can own and desire to initiate with a sense of urgency. Developing a vision is not something that can be established in any 'top down' manner. It has to arise out of the beliefs, understandings, interests and motivations of participants themselves. The team endeavours to engender a new sense of purpose and to link the interests of the participants with the possibilities offered by new model credit union development.

9. Strategies for success

The Beacon seminars aim to change the way people think about the development of credit unions as financial institutions. Through a problem-posing approach, credit union directors and staff are encouraged to think through issues together and generate solutions that can then be tested in practice. How the actions work out is discussed both in seminars and with directors and staff within each credit union.

Successful change programmes all begin with a sense of urgency and purpose. In many ways, within the British credit union movement, high levels of external subsidy and direct government support has often engendered a sense of complacency. The seminars aimed to challenge prevailing understandings, attitudes and expectations through a rigorous examination of the market and the financial and competitive realities facing credit unions.

All the managers of the Beacon credit unions initially identified the difficulties they had in developing, retaining and implementing strategic development plans. All credit unions had business plans but these were mostly of poor calibre, out of date and not used as working documents. Managers and staff were primarily so involved in operational issues that they were able to develop little time to strategic thinking and planning. They knew what they wanted to do, but the how by which it was to be achieved was somewhat more difficult and not addressed. The same was true of the volunteer boards of directors who had themselves, traditionally, been more involved in operations than strategy. Boards often made inconsistent decisions or even reversed decisions from one meeting to another. The construction of strategic business plans necessarily developed into a key role of the project team.

The project team assists the Beacon credit unions to design their business plans in a way that sets clear objectives and details how credit unions get from where they are now to where they want to go. The team assists directors and staff to set out a logical structure for how they can achieve credit union targets in membership growth, in building capital reserves, in savings growth and in loan portfolio development. This is undertaken in joint Beacon PEARLS seminars, through on-site consultations and through the supply of an ABCUL computerised business planning toolkit. The team have found it essential that business plans are:

- Realistic, robust and offer a vision of the future that engages participants interests and motivations.
- Clear in demonstrating how the vision can be achieved with specific resourced action plans.
- Based on specific steps and timetables to implement strategies.
- Convertible into financial projections and goals and link into the PEARLS analysis.

Short-term wins have been found to be very important within the process of change. Long term strategies that only begin to show results after three or four years do not engage participants' interest and enthusiasm quickly enough. Short term wins are actions that can be taken immediately and which display benefits that are visible and unambiguous. People then can see for themselves that new model development is realistic and offers positive benefits. Short-term wins have included the modernisation of lending policies, the segmentation of markets into savers and borrowers, the rationalisation of operations, improvements of premises and the introduction of new information technology systems. They have helped to model the way forward and continue to communicate the key messages.

10. Some difficult issues

The Beacon programme is revealing many of the difficult issues that British credit unions are having to face on their way to becoming effective financial providers. These issues are multi-layered and multi-faceted and have to be tackled simultaneously if effective transformation and change is to take place. The fact that multiple changes have to happen in a credit union at the same time is a key learning outcome of the programme. Marketing strategies are ineffective, for example, if systems and procedures are not in place to cope with increased demand.

What has become clear within the Beacon programme is that many of the problems that credit unions face arise from their own existing policies, procedures and operational systems. This ties into the WOCCU experience in many parts of the world where credit union problems are seen to stem not so much from external factors but from a credit union's own internal structure.

The following are some of issues being faced by credit unions on the Beacon programme, they are grouped under four main headings:

- Environmental
  - The image of credit unions within British society – credit unions are still somewhat regarded as "poor people's banks" and Beacon credit unions are finding it difficult to present an alternative and consistent

image. Some credit unions do not use the word 'credit union' in their marketing literature on the grounds that the word 'credit union' is not understood by the general population. The absence of a strong credit union brand hinders the development of a corporate image throughout the region.
  - The lack of product attraction to a wider population – credit unions still find it difficult to compete with high street lenders and, often, even with alternative lenders. They have problems competing on price, access and availability.
- Institutional
  - Restrictive lending policies - the project is endeavouring to introduce risk-based lending founded on an assessment of a person's character and capacity to repay. Some Beacons have introduced more flexible loan policies and more effective and accessible credit administration procedures.
  - Lack of operational capacity – all Beacon credit unions have a small staff team and all are dependent on volunteers for some operational tasks. The team is working with credit unions to modernise and professionalise operations within the restraints of financial and staffing resources. Implementing a radical change programme without the requisite operational capacity is the most difficult aspect of the programme.
  - Technical expertise — where technical expertise exists in a credit union definite progress occurs. Where it is lacking progress is difficult. Beacon credit unions are increasingly endeavouring to employ and recruit volunteers and staff with specific specialisms eg marketing, human resources and accounting.
  - The role of directors and volunteers – traditionally, the directors of British credit unions were very much involved in operations. The introduction of more skilled staff in operational roles has not always been matched with improvements in director skills in the governance of credit unions.
- Financial
  - There is continued dependence on external grants and subsidy and this is perhaps the most pressing issue facing the Beacon credit unions. Not only can it lead to a lack of entrepreneurship in credit unions (McKillop and Wilson 2003), its termination presents them with immense organisational and operational difficulties.
  - There is still a difficulty in attracting savings - this the central element of the new model approach and, according to Richardson, "the project's paradigm shift" (Richardson 2000b). Beacon credit unions are endeavouring to pay market rates on member savings. This is sometimes proving difficult. Even though a number of credit unions do have more savings than loans, evidence is that the majority of members' savings is kept elsewhere.
  - Interest rate ceilings – internationally the removal or relaxation of interest rate ceilings on loans, and in many cases on savings too, is a key element in the sustainable development of credit unions (Arbuckle 1994). There is increasing recognition that the ceiling of 12.68 per cent on lending is disadvantageous to credit unions which consequently cannot price loans at market rates. (Brown, Conaty and Mayo 2003)
  - Income generation and the capitalisation of earnings – all Beacon credit unions are undercapitalised even though several have made good progress recently. They will find it difficult to reach the PEARLS standard of 10 per cent.
  - The development of transaction services - credit unions are limited to generating income mainly from lending whereas, in the US, many community based credit unions generate an equal income from transaction services such as bill paying, cheque cashing and money transfers. (Jones 2003)
- Political
  - Political sensitivities – perhaps unlike other parts of the world, credit unions in the UK are enmeshed in local municipal politics. This has benefits but also certain drawbacks inasmuch as opposition to new model development can be a by-product of the local political agenda.

11. Facing the future

The Beacon programme runs for less than three years. Within such a time scale, its impact will undoubtedly be limited. Most international support programmes run for at least six or even more years. Clearly, some Beacon credit unions will be able to make significant changes, and a number are already achieving some impressive results. However, all Beacon credit unions will still face some difficult realities if they are to move forward successfully. Their first challenge is to move clearly from borrower oriented to savings driven organisations. This is the key change in the transition from traditional to new model development. It involves much more than decoupling savings and loans, still resisted by some in the West Midlands. It involves competitive dividend payments but, even more importantly, it involves ready access to savings. This point has already been recognised by ABCUL which is exploring the possibility of electronic funds transfer and modernisation of deposit and payment systems. Just Credit Union's piloting of electronic payment cards will need to be complemented with ATM cards that will allow members not just to pay into the credit union but to withdraw cash on demand as well.

Beacon credit unions also face the challenge of becoming much more service oriented. Credit unions, as not-for-profit organisations, have to be service driven if they cannot yet compete on pricing or product range. Historically, the co-operative movement was built on a commitment to quality and to service. With so many corporate scandals, credit unions have the advantage of being member owned, ethical financial institutions which, for the most part, are trusted by their members. The improvements in service delivery in the majority of Beacon credit unions, whether this arises from better access through modernised premises or a reform of policies and procedures, is a clear move forward in credit union development.

Yet, as promoted in the West Midlands project, the biggest challenge of all is for credit unions to strengthen themselves by building institutional capital and reserves. At the start of the project, some credit unions were far from a safe and secure standard and all have someway to go to meet the PEARLS international standards. The progress some Beacon credit unions have made in increasing their capital to asset ratio to date is perhaps the most significant achievement of the project so far.

However, perhaps the most important learning outcome of the project so far, is that the transformation and restructuring of credit unions into modern, customer oriented financial co-operatives depends ultimately on the strength, drive and charisma of the leadership team and the effective governance of the credit union by its board of directors.

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Notes

1 Association of British Credit Unions. ABCUL represents 412 out of the 592 British credit unions. These 412 credit unions represent approximately 82 per cent of the national credit union membership.

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