## Do credit unions have a sustainable future, or is the sector faced with a slow and steady decline?

- Introduction
- The Status Quo of credit unions in Scotland
- Are the fundamentals wrong?
- Old-model, New-model, what's the difference?
- Considering the shift to a New-model operating environment
- What rules, norms, and metrics are standing in the way of progress?
- Positioning and 'Where are we now?'
- Summary

**Introduction**

Do credit unions have a role to play in the financial marketplace today? As a niche player what segment of the general (or local) population do they target with their offering, and is there a clear definition of how they are going to fund the exercise? Many small community credit unions, defined as old-model, appear to focus on providing affordable loans to financially excluded members. This laudable aim, however, comes with a health warning:

*"When credit unions operate primarily in the sub-prime market, generating sufficient income to build the business is difficult. Serving high risk, low-income members can be demanding in resources for often small financial return. Credit unions that do not serve an economically diverse membership can remain vulnerable…"*[1]

Nothing new there, but adopting a new-model approach will help create a new image, diversify the membership, improve sustainability and help balance the sub-prime loan portfolio with loans to more financially conscious individuals.

**The status quo**

Credit union membership continues to grow slowly in the UK, but the sector is not in a good place as the numbers of credit unions continue to decline through mergers and closures. Slowly but steadily, it's dawning on some credit union boards that credit unions in their present form are not sustainable. Credit Union practioners often don't understand their existing 'old-model' well enough to know when it needs changing—or how.

Scotland's seven largest credit unions are dedicated employer focused entities with an average 20,000 members and 20 paid employees each. The remaining 96 community style credit unions have an average membership of 2,000 and 2.5 paid employees each. The majority haven't yet reached the sustainable threshold target of 3,500-5,000

[1] Stabilising British Credit Unions 2010, Paul Jones, Liverpool John Moores University.

members.[2] Community credit unions perforce rely heavily on volunteer labour and subsidies. The traditional channels to market are too narrow and accordingly, awareness of credit unions among the general population remains low. A fundamental rethink is needed.

**Are the fundamentals wrong?**

Profitability is key, driven principally from interest earned on loans. Arguably the main focus should be in targeting borrowers, but it is here that credit unions place themselves at a significant disadvantage. Credit unions wait until a member turns up, who might in time borrow. Trading companies find or attract their borrowers from the huge opportunities in the domestic marketplace. Credit unions are denied access to the wider market.

*"The growth potential is there in lending to the poor",* runs the headline in FT Money from 10th August 2015. Neil Woodford, star fund manager, is investing in Loansathome4u, a company specialising in subprime lending that charges its customers APR's in the range 50-100%. This is hardly excessive when compared to Payday lenders, but enough to deliver an impressive pre-tax profit of 24.5% of average receivables. The FT's writer concluded *"I am under no illusions this (Loansathome4u) services a segment of society shunned by mainstream banks that would be better served by low-cost lending by credit unions, churches and a government-banked bank."* Scotland's credit union sector services this segment but delivers only 2.5% PBT on average receivables (2013-14), with most community credit unions barely achieving 1%. A one per cent return is not sustainable.

In the USA, WOCCU recognised in the 1980's that the old-model wasn't working and recommended a move to a 'new-model'. Surprisingly, this research and development occurred before many of the UK credit unions were formed, but was never adopted here.

**Old-model, New-model, what's the difference?**

Old-model (Fuller and Jonas 2001; 89) has been defined as a non-profit, member owned, and democratically controlled institution chartered with the purpose of making loans available to people of small means. As the principal basis of operation, this characteristic figured largely in the demise of over 50 credit unions during 2005-10 (footnote 1). As credit union numbers continue to fall, perhaps the time has come examine a survival strategy and to break the rules, overturn the received wisdom about how things work in a *Not-For-Profit old-model* and move to a ***For-Profit new-model*** operating environment.

New-model methodology is focused on finding borrowers, since the primary income stream is interest earned on loans. The problem partly stems from a legacy issue, credit

2 ABCUL trade body Study Group kit

unions are not supposed to operate this way (but they do successfully in the USA), and a failure to grasp the unique economic, social and technical concepts of serving the needs of fundamentally different consumer market segments. Credit unions can capture business opportunities only when they design appropriate products or services and importantly, understand the business case for them. The business case is core to 'new-model' credit unions, not only ensuring sustainability for the future but through profitability, contribute more to the wellbeing of the communities in which they purport to serve.

**Considering the shift to a new-model operating environment**

The process starts with thinking about the opportunity to satisfy real customers with a borrowing need (who require a loan). Examining how your credit union will fulfill that need at a profit follows on. Finally, compare the new model to the existing model to see how much you would have to change to capture that opportunity.

A new-model approach supplements the traditional format by proactively identifying potential customers, perhaps through introductory sources including sports clubs or home improvement providers. Through the process of providing a loan, convert the customer to become a member. Every credit union is already fulfilling a real customer need with an effective business model, whether that model is explicitly understood or not.

Credit unions have no shortage of funds to lend out; they simply don't have the right customers to lend to in sufficient numbers and volume. There is no shortage of borrowers, however, so reverse engineering the member acquisition process to attract borrowers (who become members) could be key to survival, and better profitability. Credit unions have the funds, the tools and technical know-how to deliver loans; this secondary approach is simply an additional distribution channel to reach new members. Three steps to consider:

1. Think about the opportunity to satisfy a real customer who needs a loan
2. Construct a plan laying out how your credit union will fulfill that need at a profit
3. Compare the new model to the existing model to see how much you'd have to change it to capture the opportunity; e.g., to sell more products faster, the credit union may have to use the Internet to automate processes, including underwriting

**What rules, norms, and metrics are standing in the way of progress?**

The current norms have been around for 50 years. Empirical evidence shows that the 'old-model' is not particularly effective. Profitability is low acting as a brake on growth through lack of resources to employ paid staff or develop IT. Credit Unions have halved in number in the last decade. Action to stem the attrition of participants is required now. PRA quarterly metrics are not encouraging and of the last 30 calls upon the FSCS during

2010-2015 for depositor compensation, 29 came from Credit Unions. WOCCU's experience in the USA and Ireland[3] illustrates how the 'new-model' can improve the fortunes for all, while preserving the basic ethos of credit union philosophy.

But it may not always be plain sailing as the new replaces the old. In effect credit unions will have to focus on learning and adjusting as much as on executing. Credit unions with new business models must be patient for growth (to allow the market opportunity to unfold) but impatient for profit (as an early validation that the model works). A profitable credit union is the best early indication of a viable model.

Accordingly, to allow for the trial and error that naturally occurs in the creation of a new change-model the scale may be kept small consistent with the availability of existing resources, and processing customers. Most of these customers will be new to the credit union. Innovative pricing will more easily enforce premium pricing for core offerings while providing a viable alternative for the price-conscious new customer.

Transformative growth in member loans will partly spring from product or technology innovations but the principal thrust will be characterised by intervention in finding new consumer markets through a powerful business model. When developing new ways to market there may be opportunities in collaboration with other credit unions.

**Positioning and a Marketing audit – where are we now?**

Positioning: A credit union can mean different things to so many different people or organisations. Local authorities habitually view credit unions as forming part of their policy for combating debt and poverty (Fuller and Jonas, 2001; 89). Governments try to discourage the use of payday lenders in favour of credit unions (Scottish Government's 'Debtmas Campaign' 11/2013). Unsurprisingly, there is a perception among individuals that credit unions provide affordable loans (sub-prime lending) for poor people. If the non-member (prospect) thinks credit unions are for poor folk, then that's what they see. The prospect isn't rational. You see what you expect to see. If credit unions don't get into the mind of the prospect, then credit unions have a positioning problem. In the financial ladder in the prospect's mind a credit union is on one of the bottom rungs.

Where are we now: Poor positioning can restrict a credit union's aims to reach new customers. When embracing new-model thinking, a credit union's board should undertake a 'Where are we now' exercise akin to a marketing audit. This process needn't be painful and isn't exclusively linked to a model-change either.

**Summary**

Positional Improvements to consider:

[3] Management Models and Priorities in Member Associations 2014, Anne Marie Ward, University of Ulster

- Credit Unions today often carry a lot of emotional baggage from the past, especially in the title. In reaching out to a wider audience, consider dropping 'credit union' in favour of a trading name 'XX Mutual' t/a XX Credit Union
- Develop new channels for lending: attract borrowers and convert into members
- Intervention in new markets may be best achieved through collaboration with other credit unions
- Become more business orientated in outlook. Profit is not a dirty word