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CREDIT UNIONS IN A CHANGING GLOBAL ENVIRONMENT

A Presentation at the ACCU Open Forum

"How Credit Unions respond to changes in the marketplace"

Kathmandu, Nepal : 20th September 1998

by

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The macro landscape

The ongoing economic downturn in Asia shows that globalization does not represent an infallible economic sphere. Only a little more than a year ago was globalization seen as an inevitable triumph. John Naisbitt wrote about "Asia Megatrends" in which he foresaw that a cumulative revolution is taking place in Asia that will have profound consequences for world history. Asia was seen as the symbol of progress in the modern world and predictions were made that the material aspiration of middle class Asians will spur economic growth in this region. Jeffry D. Sachs, the Director of the Harvard Institute for International Development, echoed this view and said that Asia's miracle is alive and well. He said that "Asia will continue a long term historical process of catching up with the Western economies. Asia's strength of economic management, however, has not been its perfection, but its pragmatism and flexibility"[1].

Indeed, those words were said during a period when transnational companies and investors poured technology and capital into developing countries in Asia with the aim of entering the mass market of middle class consumers. But globalization creates winners and losers. In the end there are only losers. Investors pumped billions of dollars into developing nations - through bank loans, bond issues, and stock offerings – expecting high returns from borrowers.

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[1] Jeffrey D. Sachs in his column in TIME Magazine, September 29, 1997, page 36

But these borrowers were not operating by strict rules of efficiency or profit and loss. They are taking advantage of countries that are trying to maximize the benefits of globalization while minimizing changes to their own politics and trade regulations. In some countries in Asia, "CCN" became the name of the game. Crony capitalism has meant Corruption. Contracts were usually won with bribes (Collusion), and favoritism were given to the well-connected (Nepotism). In the end, stock markets collapsed and capital outflow by these same investors has forced Asian countries such as Thailand, Korea, Indonesia, and Malaysia to scramble in order to conserve their scarce foreign reserves. The rippling effect of this financial turmoil has hit Japan and Russia more recently, and will no doubt affect other regions as well.

Globalization assumes that physical capital, and technology, is basic to progress. Global capitalism and investments was thought to give rise to produce development. As such, the human factor is relegated to just a peripheral position; and the perspective on change is typically of short term nature.

In my presentation on the "Role of Co-operatives in the Changing Context of Development" presented at ACCU's Regional Workshop in Colombo, Sri Lanka, in May 1995, I described that: "*Even when nations have made economic progress, quality of life improvements have not been evenly shared. The collapse of Communism meant victory of market economics. But market forces have the tendency of accelerating the exploitation of the underprivileged and their physical environment. Globalisation of market forces have also undermined systems of governance in many developing countries that turn both rich and poor into unscrupulous entrepreneurs. As a result, people do not develop confidence in the market because violation of rules goes unpunished, and "getting prices right" involves a drastic and sudden rise in cost of living. This basically widens and deepens the gap between the rich and the poor. The global restoration of the principles of the free market - no doubt beneficial to some people who earlier suffered from the effects of over regulated economies - has left the market without a rival*"[2].

The economic crisis in Asia has caused the biggest setback to human development in the past year, where in Indonesia alone people below the poverty line has risen to more than 50%. But at the same time the crisis offers an opportunity for a re-assessment of domestic and international economic strategies.

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[2] Report of the Regional Workshop on " Project Financing for Low Income Earning members of Co-operatives", organized by the Association of Asian Confederation of Credit Unions in Colombo, Sri Lanka, May 25-29, 1995, page 39.

Strategies must strive for "Growth with equity", using human indicators alongside economic and financial ones.

The UNCTAD (United Nations Conference on Trade and Development) in its current session urged a worldwide policy to spur economic growth based on lower interest rates, greater government spending and global rules to protect countries from currency speculators and flighty investors. UNCTAD basically put blame on the IMF for worsening of the Asia economic crisis because its austerity plans impose hardships on the poor developing countries who depend on government jobs, public programs, and low interest rates to survive. UNCTAD argues that budget-cutting, tight-money policies imposed under IMF-led bailouts simply protect the interest of international investors who knowingly accepted the risk that they would lose money should the local currency weaken. (The Wall Street Journal, September 18, 1998).

While the above may be considered a prompt reaction to the current austerity programs at the *macro* level being imposed by industrialized countries and the IMF, it may be a short term remedy if increased government spending do not focus on the right sectors and are not supervised carefully. Tighter control on capital outflows will also discouraged foreign investors, although it would prevent the need for further bailouts by the IMF. Such macro policy must be balanced by micro interventions at local community levels hardest hit by the crisis.

Need for Micro interventions

The widening gaps caused by the failure of global capitalism and market reforms in developing nations must be filled not only by correcting macro policies, but more so by launching micro interventions to help those most adversely affected. Co-operatives and credit unions in developing countries can play an important role in mitigating the negative impact of the financial crisis by filling and narrowing the gaps in equity and good governance. This is particularly important in countries where broad participation in civil society is still largely absent, and where the pursuit for growth strategies does not bring benefit to the masses. Micro intervention is an imperative because of the concern for the community and the need to strengthen local economies. The influx of global capitalism has benefited only rich investors and in turn created the widening gap between rich and poor.

There is no doubt that the financial services' marketplace will continue to be shaped by the forces of globalization, because a borderless world for financial institutions has been created electronically. But the recent financial crisis has shown that short-cut approaches or quick fixes will not work. Transformation in the marketplace requires a gradual shift from a business-dominated sphere to a consumer-oriented one, not by economic engineering alone but also by adapting to local cultures and politics of the developing nations. Because countries may adopt trappings of modern technology and capitalism without necessarily embracing the societal values and making the system work. The corporate financial institutions usually maximize their profits by portraying the "image" of a viable financial system, using modern and glittering facades, so that confidence is build among the public. But co-operatives and credit unions are different from the conventional business corporations.

First of all, credit unions cannot promote network-building in the same way as would conventional businesses. Business corporations generally establish business networks and alliances with the main purpose to increase shareholders' capital. They are not concerned with community development or the strengthening of local economies. With the current globalization of markets, businesses are increasingly accountable to their shareholders that are located anywhere in the world. Likewise, with globalization, businesses identify less with the development of their country or region, and are less accountable to their communities. Just witness the massive capital outflows at the present time, which are hurting the developing countries in Asia and hence deepens the economic crisis.

In the past, businesses were close to their markets. *They assumed certain responsibilities for development in their community.* In this day and age, however, businesses are increasingly becoming anonymous entities as they focus single-mindedly on paying attractive dividends to shareholders who, above all, seek the accumulation of individual wealth, without regard for the development of their community. If money can be made by doing business on world markets, they will gladly comply, despite the possible negative impact on their own community.

Credit unions do not pursue the *motive* of profit maximization, although it must naturally make profits. Their main role and motivation is to promote and contribute to greater economic and social wellbeing of members and the people in their communities.

That, again, is their reason for being. As agents of change, co-operatives are not capital investors seeking maximum return in the most profitable markets. Co-operatives represent first and foremost groups of individuals banding together democratically, to form their own businesses and meet their needs.

But credit unions and co-operatives must be aware of the fact that massive changes on a global scale will have a direct impact on them. With the spectacular evolution of communication technologies, the world is a much smaller place. We live in a world where markets have no more boundaries.

This new changing world must be perceived as opening up opportunities for co-operatives. Co-operative businesses must become the building blocks for community development. We should know that the trend to global markets is forcing peoples in different parts of the world to combine strengths and develop strong grassroots economies in line with their local needs. This is much in line with the underlying reason for credit unions to subsist: to shape and sustain economic development by working together closely when entering the market place.

Professionalism with community orientation

Gone are the days when the credit union movement was simply perceived as "**do-gooders**" because they must now be "**doing good**", i.e. effective and efficient in fulfilling its economic and social mandates. Credit unions can no longer survive by simply being a community-based organization that provides soft loans and employs voluntary managers. Most of us still remember that credit unions in this region were organized in direct response to the lopsided credit market being created by money-lenders in the past. As a response to make the market more equitable for the poor, credit unions introduced cheap credit and, in some cases, collective loan portfolios. Now money lenders are replaced by private commercial banks, and more pointedly, by parallel co-op cultures that are promoting micro-finance schemes. The fact of the matter is that many agencies are aware of the success stories of credit unions in that the poor have good credit rating because credit unions maintain high levels of loan recovery.

Therefore, in the new competitive era, credit unions must gain competitive strength and must do so by setting their houses in order.

They must become viable business enterprises but owned and used by members in their communities. Credit unions must take up a ***strategy that is demand driven*** rather than supply-driven, the latter being merely a means for supporting community development. A demand driven strategy entails reforming credit union institutions that will create better and competitive products and services that are in constant demand by members because they feel (proud) that these products and services have VALUE. Value because members FEEL they own the products and services, and are determined to use it because these products and services are ethically sound and of better quality than banks.

For credit unions to become demand driven, they must hire (and not *fire*) professional managers that are not only knowledgeable about market competition and quality management, but also committed to the values and principles of the credit union. This can only be done if professional managers are hired as part of the policy-making structure in the credit union. This is the most difficult part of the institutional reform process in the credit union because they have been accustomed to the traditional governance in splitting board and management functions. The more so if some board members, without any professional qualification, would like to get continuously involved in the management of the credit union.

Earlier this month ICA conducted a global Training Seminar on "Value-Based Management" in Pune, India, in which Dr. Peter Davis illustrated in great detail this very important concept.

> Value-Based Management is a powerful concept that will have universal applicability. It stresses on a clearly defined co-operative purpose with a set of values that can form the basis for a unified organizational culture that is shared by management and membership.[3]

Arguably, credit unions and co-operatives must undergo a shift in paradigm in order to build a united team of elected members and top management, so they can collectively serve the entire membership to meet the co-operative/credit union purpose.

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[3] Peter Davis, "Towards a Value-Based Management Culture for Membership-Based Organizations", presented at the Special Workshop on the "ICA Co-operative Identity Statement – *from theory to practice*", Jaipur, India, August 17-21, 1997.

It also means that credit unions must promote and hire managers who are professionally trained in mainstream business management. It means that credit unions must not only be committed to create the financial resources to do so, but also willing to change their conventional wisdom of separating board and management, and adopt the new concept of Value Based Professional Management.

THE QUEST FOR "NEW AGE" LEADERSHIP

If we believe that credit unions must change its paradigm, and adopt ***Value Based Professional Management,*** it must also be premised on the need to have elected leaders who can build collective competency with the professional managers as a united team to achieve the credit union purpose. Do we have elected leaders in the credit union who are ready to take up this new dimension? There is the challenge of developing "new age" credit union **leaders** who should quickly realize that they have this (narrow) window of opportunity to do so.

Elected leaders need to understand that professional managers, when given the opportunity to internalize and share the strength of the co-operative identity statement, they can use this strength in a much better way to serve their members without compromising their professional management capabilities. It rests on the assumption that services that are value-based will be superior to those provided by any other corporate competitor, because co-operatives are owned by members who are also ***users*** of these services, not just any customer. It will also reduce the political bias in the organization because they will focus more on the "business" of the credit union and compete with "outsiders" rather than "insiders". Managers can also be leaders first, and manage second. This involves a new paradigm, where co-operative/credit union board of directors will become more proactive by engaging professional managers as equal co-leaders in their decision making processes: a process that will allow policy-formulation to be driven by both member-led philosophy and business results.

A "new age" leader, therefore, must in the first place understand their members, their needs, what motivates them, how they think, and how they react. Combined with management skills in risk taking, long term visioning, and challenging old conventions, such a leader usually lead others to action and performance.

But in the co-operative system, leaders also need to understand the values inherent in the Co-operative Identity Statement. This will differentiate the co-operatives from other private corporations.

Shift in paradigm means changing the mindset of co-op/CU leaders as well. We need credit union leaders who are more transformational in their thinking rather than just reformative, the latter being perceived as more short term in nature. We need leaders who rely more on meeting members' aspirations, as well as their socio-economic needs, rather than just thinking about their own survival. Leaders who believe that they can extend value-added services which members are willing to pay with both *"money, loyalty, and enthusiasm"*, rather than just regard members as consumer-minded customers. Hence we need leaders that are both transformed and transformational.

Transformed because leaders: (a) use their right wisdom, understanding, and professional acumen to create change, to develop members, and to build better communities; (b) leaders who are participatory in both governance and decision making processes; (c) leaders who accord priority to members needs over profit maximization.

Transformational because leaders that can create processes that balances professional management with members' satisfaction, using holistic, integrated and life-enhancing strategies. Transformational processes are seen as processes that lead to the creation of sustainable co-operatives, whereas reformative processes are more institutional and short term. As the latter is institutional-driven – and not member-driven and value-based – it usually result in the creation of disconnected professionals who are protagonists of demutualization and privatization of co-operatives.

KEEP THE CREDIT UNION CONCEPT INTACT (AS "THE" LEGITIMATE SYSTEM FOR FINANCIAL INTERMEDIATION).

With new changing environment, credit unions need to make adjustments, but should by no means change its IDENTITY, principles and values.

There is currently a surge of micro-finance schemes being promoted by multilateral organizations such as the World Bank and the Asian Development Bank.

These schemes are all well intended because of the primary mandate accorded to these agencies to promote poverty-reduction programs. Rural Banks, NGOs, and self-help promoting organizations (SHOs) are seen as major conduits for supporting micro-finance because they are generally more adaptable to debt-based lending mechanisms.

Credit unions and co-operatives are seen by governments, as well as by communities, as being rather inflexible because of their "closed" nature. NGOs and SHOs are not member-based and have the flexibility to deliver loans based on their grassroots presence. But due to the lack of "business experiences", and also the absence of long-term equity within their organization, plus the fact that they are more voluntary in their operations, they also tend to be less accountable. They are also more prone to ideological and political disputes because of their skeptical views towards government policies. Small Rural Banks would be a logical conduit for delivering micro-finance because of their institutional presence in rural areas. But many state-banks in the rural areas also suffer from bureaucratic hurdles.

It can be argued that credit unions are the most relevant and more sustainable modality for delivering micro-finance programs. But it must be premised on their willingness to widen their markets by enlarging their membership base in rural areas. Credit unions, as it turn out, are often stigmatized by the community as a 'closed bond societies', hence lacking flexibility to deal with immediate needs of the community. If only credit unions can have greater outreach to the community and offer services like those being offered by viable local commercial banks, they will become the best modality for rural micro finance and outstrip many other institutions.

It is therefore important for the credit union movement to enhance their image as a solid institution that is safe and sound, because of their service to members of the community that goes beyond just micro-finance, but also the provision of insurance, deposit protection, inter-lending, and many other financial services. Most of all, these services are value-based and owned by members themselves.

As a financial system credit unions must therefore raise their public image in order to compete with their "parallel cultures". Credit unions would be much ahead of the other finance modalities mentioned earlier, especially if they can be more demand-driven by creating the following support structures:

- ***Credit Union Law***: there is no separate credit union law in many countries, and registration under the general non financial-sector law usually obscure their public image;

- ***Professional Management***: management in many credit unions in developing countries is still largely based on voluntary efforts, hence weakening internal check and balances as well as financial strength (and may take longer to adopt "value-based management");

- ***Competitiveness***: products and services are in many ways not yet competitive as compared to banks, hence weakening its financial strength (this is largely related to the lack of professional managers in the credit unions as mentioned in item 2 above);

- ***Marketing strategy***: market information and product development system are not readily apparent;

- ***Deposit Guarantee***: deposit guarantee funding (stabilization fund) has not been instituted in many movements in developing countries;

- ***Business Planning***: As a financial system credit unions have not set annual revenue targets with competitive pricing analysis to pay for basic needs such as professional full-time management, hence weakening its public image and institutional strength;

- ***Capital adequacy***: as a financial system many credit union movements have not build up enough capital to support structures at all levels. Financial support from the base level all the way up to the national level tend to be incoherent, hence creating dependency on external funding most of the time.

But the credit union concept is still sound and relevant. If credit unions can continue to strengthen their competitiveness through their **safety and soundness** programming, plus **incorporate value-based management** and promote **new-age leadership**, they will become the ideal institution to fill the equity and governance gaps caused by the turbulent economic turmoil in this region.

It would be pertinent to point to the credit union system in Canada, for example, that is also trying to mitigate the effects of massive mergers of large banks in the country. The credit union movement continues to be vigilant in maintaining their identity and also in their search for a solution in spite of a recent independent business owner survey indicate that "those who use credit unions are the most satisfied with their financial institution". This survey was undertaken 95 years after the first credit union was organized in Canada.

Which only proved that having a strong organization with a positive public image is indeed very crucial to attaining success, but that they should never stop them from looking beyond the present.

CONCLUSION

Excessive globalization has its limits, as business and countries are learning from the economic crisis in Asia. Despite all the progress of recent years, the gap between rich and poor widens. The world report on human development points out that, whereas in 1970 the richest 20% shared 70% of world income, today they receive 83%. There are today 80 million rich people in the world earning more than US $ 12,000 compared to 4 billion poor people earning under US $ 3,000. Many of our countries are also subject to these income extremes between the rich people in the world earning more than US $ 12,000 compared to 4 billion poor people earning less than US $ 3000. Many of our countries are also subject to these income extremes between the rich and poor, and the world economy has no solutions.

In this context, the co-operative and credit union formula augurs well for the challenges we will face in the next Millennium. We as co-operators must aim for more than national and regional growth through the genuine development of our communities. We must make ail efforts to create living environments where people interact better, together, but with a strong business platform that they themselves can own and utilize. Only communities can construe such economic activity can live with total dignity.

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