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From tackling poverty to achieving financial inclusion—The changing role of British credit unions in low income communities

Paul A. Jones *

Research Unit for Financial Inclusion, School of Applied Social and Community Studies, Faculty of Health and Applied Social Studies Liverpool John Moores University, Fouth Floor, Kingsway House Hatton Garden, Liverpool, L3 2AJ, United Kingdom

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Abstract

This paper offers an analysis of the changing role of co-operative credit unions in tackling poverty and promoting financial inclusion in Britain. It examines the reality of poverty in low income communities and endeavours to critique the actions, methodologies and initiatives currently being adopted by credit unions to achieve financial inclusion. It examines the role of the UK government in its support for credit unions and offers an early analysis of HM Treasury's Financial Inclusion Fund. The paper argues that credit unions are best placed within the financial services industry to make an impact within financially excluded communities.

JEL classification: G1; G2; I3

Keywords: Credit unions; Poverty; Financial inclusion; Low income communities; Financial services; Organisational reform; Co-operatives

1. Credit unions as anti-poverty initiatives

Poverty remains a major social and political issue in Britain. In 2003/2004, 12 million people were living in income poverty (Palmer et al., 2005). Of these, 3.5 million were children, a definite increase on the 1.9 million children living in poverty in 1979 (Flaherty et al., 2004; UNICEF, 2007) and a figure which rose to 3.8 million in 2007 (DWP, 2007). The poverty rate for working-age adults has remained unchanged at 19% for a decade (Palmer et al., 2006). In 2005, 50% of those living below the poverty threshold were living in just 20% of the small local neighbourhoods in Britain (Palmer et al., 2005); a reality confirmed earlier by HM Treasury (2004). For the most part, poverty is concentrated in low income and often distressed neighbourhoods where it is likely to be long term and entrenched (Hills, 2004).

It was the experience of poverty, particularly during 1980s and 1990s, that motivated hundreds of volunteers to establish local community credit unions as a solution to the financial needs of the poor (Jones, 1999). Alienated from banks and unable to access mainstream financial services, people in low income communities operated in a cash economy and, as need arose, had little choice but to borrow from home credit companies and other sub-prime lenders at rates of interest that rose regularly to over 200% APR (see Kempson, 1996; Jones, 2001b; Palmer and Conaty, 2002). Whether in Toxteth, in Liverpool, where the adult unemployment rate was 38% in1989 (Jones, 2001a), or in Bridgeton,

* Tel.: +44 151 231 4415.
E-mail address: P.A.JONES@LJMU.AC.UK.
URL: http://www.ljmu.ac.uk/HEA/financialinclusion/index.htm.

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Calton and Dalmarnock (NCUSWG, 2001), the response of community activists to poverty lay in co-operative self-help and credit union development. In 1986, there were just 94 British credit unions. By 2000, there were almost 700, the majority of which were in low income neighbourhoods (Donnelly, 2004). By 1999, 83% of all community credit unions had been formed with the support of the local authority and the express purpose of tackling poverty and providing services for disadvantaged people (Jones, 1999).

Political support for credit unions was high during 1980s and 1990s as they became part of local and central government discourse on tackling poverty and disadvantage (HM Treasury, 1999). With the support of publicly funded grants and resources,[1] and the intervention of local authority development staff, credit unions expanded rapidly (Jones, 1999; Goth et al., 2006). Yet, as Ward and McKillop (2005) point out, despite government intervention, the development of credit unions in low income communities was disappointing. By 1998, with few exceptions, the average membership of the majority of community credit unions in England and Wales was only around 200 members, and it was only marginally greater in Scotland with around 400 (Jones, 1999). Most British credit unions serving low income communities remained financially weak, vulnerable and very small (Jones, 1999; Goth et al., 2006). Goth's analysis of the 2001 credit union financial data questioned the long-term survival of at least 50% of all British credit unions (Goth et al., 2006). By the end of 1990s, local and national government recognised that public investment in credit unions had not matched up to expectations (HMT, 1999; LGA, 1999, 2001). This led some commentators (Ryder, 2002; McKillop and Wilson, 2003; O'Connell, 2005) to the conclusion that poor credit union growth and performance arose specifically from linking the purpose of credit unions to poverty alleviation and tackling disadvantage. McKillop et al. (2007), quoting Rossiter (1997), claimed that the circulation of the money of the poor within poor communities led inevitably to exclusion ghettos. For McKillop et al. (2007), credit unions that focused primarily on low income communities were doomed to failure. It was this same analysis that led Dayson et al. (2001) to view credit unions as limited in their potential to serve low income communities and to argue for new forms of community development finance initiatives (CDFIs) that could, in their view, tackle poverty more effectively.

2. British credit unions – reform and transformation

Faced with the challenge of poor growth, research recognised that credit unions had to adopt more professional and business-like approaches if they were to succeed in the low income market-place (Jones, 1999). From 1999 onwards, the Association of British Credit Unions (ABCUL), the sector's largest trade association, abandoned its traditional approaches to development based on small common bonds, volunteerism and informal collective action. It recognised that this only led to the creation of weak and ineffective organisations that lacked the professionalism and capacity to serve low income communities effectively. Instead, ABCUL began to promote a business focused approach based on robust business planning, suitable premises, introducing IT and on employing staff instead of depending upon volunteer labour. This resulted in the strengthening of a number of credit unions and in an increasing number of mergers as credit unions endeavoured to benefit from economies of scale. It was a move that received the support both of government and of local authorities (LGA, 2001).

However, international research (Arbuckle, 1994; Richardson, 2000a,b; Branch and Cifuentes, 2001) convinced the British movement that if credit unions were to succeed in making a real and lasting impact within low income communities, a much greater reform, than envisaged initially by ABCUL, would be required (Jones, 2004b). International case studies revealed that credit unions, established with the social purpose of serving poor communities, had the real possibility of becoming stable and effective financial institutions, if, and only if, they adopted a radical commercial approach to organisational development. As Richardson and Lennon (2001) argued, if credit unions were to achieve social goals, they first had to attend to achieving their economic ones. Contrary to Ryder (2002), McKillop and Wilson (2003) and O'Connell (2005), who regarded the focus on low income communities as the cause of credit union poor performance per se, these international studies saw the problem not so much arising from serving the poor but rather from the lack of realistic and effective approaches to organisational development.

[1] In 1999, it was estimated that £10–£15 million of public investment was spent each annum on credit unions and credit union development (Jones, 1999). This was made up of £9.6 million spent on credit union development agencies (established to work with the volunteers managing the credit unions) and the remainder on direct grant income from local authorities, the Single Regeneration Budge, the European Social Fund and other public sources. This grant income mainly paid for capital and material costs, accommodation, training costs and running costs. It was not, at that time, often given for credit union staff. It aimed to enable credit unions to cover the costs of operating as small community organisations.

The transformation of credit unions, as argued for in the international studies, entailed more than the adoption of basic business practices, as already recognised by ABCUL and increasingly by local and national government. It demanded a radical financial, organisational and operational restructuring (Arbuckle, 1994; Richardson, 2000a,b; Branch and Cifuentes, 2001) that came to be known as new model credit union development (Arbuckle and Adams, 2000; Richardson, 2000b; Jones, 2004b, 2005). New model development was seen as a major correction in the management and organisation of credit unions in order that they could develop the capacity and products to serve low income communities effectively.

A commitment to new model credit union development has characterised the British credit union movement since 2002 when it became a central element in ABCUL's strategic development plan (ABCUL, 2005a; Jones, 2005). The reform was based on seven key elements, all of which would pose significant challenges to traditional model credit unions operating in low income communities. Richardson (2000a) regarded these elements as seven *"doctrines of success"*. The first element was to serve the financial needs of a wider population, rather than to focus entirely on the poor and disadvantaged. At first sight, this might appear to confirm the analysis of Ryder (2002), McKillop and Wilson (2003) and O'Connell (2005) that focusing on poor communities was at the heart of the problem. However, this is not the case. Focusing on the poor is not in itself the problem; in fact most of the international studies concerned credit unions that primarily served disadvantaged communities. In her Sri Lankan study, Evans (2001) argued convincingly against what she termed *the middle class myth*, that successful credit unions are only those that prioritise middle-income salaried people. The paradox for credit unions was that, if they were to prioritise serving the poor, they needed also to broaden their appeal to wider sections of the population. This is not just to generate income from larger savers and borrowers but to ensure that the less well off are not left feeling stigmatised within what could be perceived as a social welfare organisation. The *poor persons*' *bank* appeals least to the poor themselves.

The second element of new model reform was the maximisation of savings. Traditional British anti-poverty credit unions had concentrated primarily on offering low-cost loans and only marginally promoted savings. The assumption was that the poor were unable to save and that it was more important to offer affordable credit to reduce dependence on high cost sub-prime lenders than promote savings. Combating sub-prime lending was at the heart of the anti-poverty credit union strategy. The argument was that this reduced high cost interest repayments on loans and so increased the income available to borrowers and their families. At the same time, it improved the local economy as borrowers tended to spend their income locally. The new model methodology of prioritising savings was a sea change in how credit unions operated. It was based on a fundamental understanding that it is savings, and the building of assets, that above all moves people out of poverty over the longer term. The fourth element of success was product diversification or offering a range of financial products in response to people's needs and wants. This was a major challenge to credit unions as traditionally they offered a single identical savings and linked loan account to all. It was to become clear that inflexibility of being product, rather than member, led resulted in even greater financial exclusion. The next three elements were operating efficiency, financial discipline and self-governance, all of which would demand a major review of operating procedures and practices in credit unions. The seventh was assimilation. By this was meant the capacity of bringing the poor "*into the mainstream economy by providing them with access to comparable financial products and services*" to those found in conventional financial institutions (Richardson, 2000a). It was this final element that challenged credit unions to rethink their role as anti-poverty initiatives and to consider how they could offer pathways to long-term financial inclusion to people in low income communities. The traditional credit union focus on providing low-cost loans certainly alleviated distress and raised incomes but, for the most part, left the poor and on the margins of society.

3. From tackling poverty to achieving financial inclusion

The importance of the shift from tackling poverty, through low-cost lending, to a more strategic approach, based on promoting pathways to financial inclusion, was highlighted in a Barclays' research project into credit unions and loan guarantee schemes (Jones, 2003). This research focused on five credit unions, all in low income areas, which established, mostly from grants or charitable donations, loan guarantee funds to enable them to make debt-redemption loans to people indebted to high interest lenders and unable to save to qualify for a loan. The findings revealed that such an ad hoc response to poverty and debt achieved little. Loan default rates for these loan products were higher than the credit union's traditional loan portfolio and few people subsequently moved into financial stability. The research concluded that if credit unions were to serve low income consumers of high interest loans, they needed to respond to their multiple and multi-layered needs. The Barclays report recommended that such a holistic approach included one-to-one personal support, money advice, help with budgeting, savings facilities, financial education, in addition to access to affordable credit.

The Barclays report revealed, at least in outline, the dynamics of the interplay between poverty and financial exclusion in the lives of people on low incomes. With no access to, and no usage of, the financial services taken for granted by most consumers, people have no choice but to pay higher charges on transaction services to cash cheques and pay bills, are vulnerable to high cost sub-prime lenders and often make poor money management decisions. Financial exclusion is a result of poverty (Collard et al., 2001; DWP, 2001; Carbó et al., 2005) but it also leads people into greater poverty and over-indebtedness. It was for this reason that the National Consumer Council argued that achieving financial inclusion was essential to tackling poverty (NCC, 2005a).

Considerable research has been undertaken into the financial needs of low income and financially excluded consumers (Kempson, 1996, 2002; Kempson and Whyley, 1999; Jones, 2001b; Collard et al., 2003; Collard and Kempson, 2005) which confirms the diverse and multiple realities of financial exclusion. Financial exclusion is characterised not just by a lack of affordable credit but by having no savings, no bank account, no assets, no access to money advice and no insurance (HM Treasury, 1999, 2004, 2007a,b,c,d,e). The challenge for new model credit unions was to respond to the needs of people on low incomes by addressing each of these elements in a co-ordinated, strategic and holistic manner.

The growing realisation of the interplay between poverty and financial exclusion added weight to the recognition by credit unions that they required significant organisational capacity and reform if they were to contribute meaningfully to the lives of people on low incomes. The complex character of financial exclusion demanded joined up solutions that only strengthened new model credit unions could provide. This was accepted by Collard and Kempson (2005), Rossiter and Cooper (2005) and the National Consumer Council (2005a,b), and also by McKillop and Wilson (2003); all of whom concluded that the needs of the financially excluded were best served within strengthened new model credit unions. This has precipitated a wave of credit union strengthening programmes throughout Britain over recent years, such as ABCUL's West Midlands project, which, from 2002 to 2005, saw an increase of 27% in savings and 23% in loans in participating credit unions (Jones, 2005). It also prompted ABCUL, with the support of Barclays, to introduce the PEARLS financial monitoring system into Britain (Richardson, 2001; ABCUL, 2005a). The result has been that an increasing number of professionally organised, quality credit unions (a term that has now replaced new model in the British context (Jones, 2006)) have been established that currently, or are planning soon to, offer financially excluded groups access to current accounts, flexible savings accounts, instant and accessible loans, bill payment accounts, affordable home and contents insurance and access to money advice and debt counselling services. Such credit union includes Southwark Credit Union in London, Hampshire Credit Union on the south coast, Capital Credit Union in Edinburgh and Hull and East Yorkshire Credit Union in Yorkshire.

The credit union move to promote financial inclusion was influenced by changes in government policy. Banks and mainstream financial institutions had long since withdrawn from low income communities as they refocused their business on more affluent, profitable customers (Leyshon and Thrift, 1993; Sinclair, 2001; Midgeley, 2005). This prompted the UK government to place improving access to financial services at the heart of its attempts to provide solutions to social exclusion and to promote renewal in deprived neighbourhoods (HM Treasury, 1999, 2004; Kelly, 2002; Marshall, 2004). Government originally conceived of creating its own universal bank (PIU, 2000) which would have itself provided financial services for people on low incomes. After, what Marshall (2004) describes as tortuous negotiations between the banks, the post office and the government, the universal banking idea was modified, in 2003, into the provision of Universal Banking Services. This was to be achieved through the development of the post office card account (POCA), through which welfare benefits could be paid to claimants, the promotion of basic bank accounts,[2] and the extension of the post office facility to cash personal cheques and make deposits for current account holders of a number of mainstream banks. Importantly, in 2004, government strategic thinking on financial inclusion widened to include the expansion of money and debt advice services and the strengthening of the community

[2] A basic bank account enables the receipt of wages or benefits, deposits of cash and cheques, ATM cash withdrawals and the payment of bills by standing order or direct debit. Its most obvious limitation is that it does not have an overdraft facility, designed in such a way that they can be made available, in theory at least, to people who would not qualify for a traditional current account. There is no access to other credit facilities for account holders. There are no charges for day-to-day banking, but banks tend to make significant charges if there is insufficient money in the account to pay a standing order or direct debit.

finance sector (HMT, 2004). It was the political decision to strengthen the community finance sector that facilitated the beginnings of a new partnership between government and credit unions. Despite the earlier disappointing results of public investment in anti-poverty model credit unions, government was sufficiently convinced of the potential of new model credit unions that it initiated a series of regulatory and legislative changes designed to strengthen them and to assist their development in the low income market (see Jones, 2006; McKillop et al., 2007). Rather than develop a new solution, the government sought a new strategic partnership with credit unions to provide people with a route into financial inclusion (HMT, 2004; HCTC, 2006a,b)

4. The credit union path to financial inclusion

Despite the reservations of some commentators, as already noted above, there is significant evidence that credit unions can succeed in prioritising the low income market so long as they have a robust commercial approach to development, have effective management systems in place and offer products and services that are attractive both to low income and to moderate income consumers (see Branch and Cifuentes, 2001; Richardson, 2000b; Jones, 2004a,b). International case studies have demonstrated repeatedly the ability of credit unions to serve poor communities world-wide (Arbuckle and Adams, 2000; Evans, 2001; Nyirabega and Ford, 2005).

Research undertaken by Collard et al. (2003) revealed that low income consumers, in fact, prefer to deal with locally-based community organisations, partly because of ease of access but also because they mistrusted banks and mainstream financial providers. However, Collard et al. (2003) stressed that financially excluded people also want financial products and services to be delivered by established and professional providers with well-trained staff. The traditional model approach of the anti-poverty credit union, organised and operated by volunteers, often on an informal basis, offering a limited range of products and services, is not the kind of poor person's bank that appeals to many people, particularly the poor. Some British credit unions have turned to the United States for models of credit union development that combine social embeddedness within a community, a professional approach to product and service delivery and a focus on serving lower income consumers. Brown et al. (2003) have argued, for example, for the approach taken by US community development credit unions (CDCUs). One such CDCU is Alternatives Federal Credit Union, in New York, which has developed a "*Credit Path*" model which describes the process of moving from poverty into inclusion and financial stability and which is based on a continuum of personal financial development through four key stages; transactor, saver, borrower and owner. Based on this model, Alternatives FCU was able to design products and services to meet the different needs of low income members at various stages of their development.

Mahon and Northrup (2006) questioned the accuracy of seeing the elements of the "*Credit Path*" as a sequence as if the path to financial inclusion involved a progression over time from transactor to owner. In their research, Mahon and Northrup found that Alternative Credit Union's members used different products at various stages depending on their personal circumstances and not necessarily according to any particular sequential pathway. Personal financial development was more complex than the credit path seemed to indicate. However, they maintained that these four constituent elements of transaction services, savings accounts, affordable loans, and asset accrual (ownership of property or a business) described an effective framework for the design of products and services that assist low income members into financial stability. In Britain, these four elements, with the addition of financial capability education, access to money advice and to insurance products (HMT, 2004, 2007a) are now regarded as fundamental elements of a path to financial inclusion that have to be provided by credit unions that endeavour to assist people into financial stability. For British credit unions, addressing each element effectively has entailed facing significant challenges and reform.

4.1. Basic banking and transaction accounts

Traditional anti-poverty credit unions did not offer current or transaction account services. They operated as local, volunteer-run, alternative savings and loans co-operatives that had little desire to offer products or services that resembled mainstream banking. Fuller and Jonas (2002) argue, for example, that traditional credit union development owes more to the concepts of social capital and community empowerment than it does to theories of economic development. Credit unions prioritised autonomy in ways that kept them apart from the financial mainstream.

Yet, as Alternatives FCU's "*Credit Path*" demonstrates, access to transaction banking is central to the path to financial inclusion. Not only is having no bank account a barrier to employment or starting a business, it results in having to pay far higher charges for cheque cashing and for paying utility bills (Brown and Thomas, 2005; Herbert and Hopwood Road, 2006). No bank account contributes to people failing to grow in financial capacity, limits access to money advice and results in a poor credit score. For the most part, as Meadows et al. (2004) revealed, the unbanked are disproportionately drawn from social networks where few people have bank accounts and where knowledge about financial affairs is mainly drawn from family and friends. The result is financial information failure and poor financial capability. A bank account is increasingly recognised as acting as a gateway to a range of other financial services[3] and as necessary to progress into longer term financial stability (Hogarth and O'Donnell, 1997; Collard et al., 2003; Bridges and Disney, 2004; NCC, 2005a). This is acknowledged by the credit union movement (see Jones, 2008) and is now government policy (HCTC, 2006b; HMT, 2007a). Consumer advocates such as Citizens Advice (Herbert and Hopwood Road, 2006) and the New Economics Foundation (Brown and Thomas, 2005) have called for the provision of fair and cost effective transaction banking services that combat financial exclusion.

Research suggests, however, that the two major transaction service options, developed as a direct result of government policy to achieve financial inclusion, basic bank accounts and the POCA, fail to provide appropriate banking transaction services. Herbert and Hopwood Road (2006) identified and analysed a range of difficulties with basic banks accounts which, in many cases, were demonstrated as not operating in the interests of low income consumers. There were problems with both opening and using accounts as they were not widely promoted by bank branches or readily available to consumers. In addition, the impact of charging structures, for such items as declined direct debits and standing orders, most heavily penalised low income consumers. With no overdraft facility and no access to small sums of credit, basic bank accounts were a gateway to nowhere. In fact, US experience with equivalent accounts was similar, with Caskey (2002) wondering why low income people would ever be attracted to such accounts when they risk incurring high penalties and charges. This led the National Consumer Council to conclude that the current model of basic bank accounts introduced by government in 2000 is not achieving the original objective behind their development. (NCC, 2005a)

With its limited functionality, as merely a conduit for welfare benefit payments, Marshall (2004) considered that there were also good grounds for scepticism that the POCA could ever bring people into financial inclusion, even though it was considered by government and by the British Banking Association as a stepping-stone to financial inclusion (HMT, 2004, 2006). Marshall considered that its introduction was more an attempt to solve the problems of the post office than a serious attempt to address financial inclusion issues. Midgeley (2005) agrees and goes further to question whether financial inclusion was ever a real aim of universal banking. He argues that it was more to do with finding new business to maintain the post office system and cost effectively modernise welfare payments. Indeed, POCA's limited functionality and inability to offer no more than a transactional account for benefit payments does not provide anyone with a pathway towards financial inclusion.

Despite these difficulties, the underlying reasons for the introduction of basic bank accounts and POCA remain valid as people need transaction accounts to take the step up into banking services and into wider financial inclusion. For this reason, the development of a 'banking services' project became, in 2003, a key strategic goal for ABCUL. This goal was achieved in 2006 through a partnership with The Co-operative Bank.

ABCUL's partnership with The Co-operative Bank is based both on co-operative and commercial principles. It enables credit unions to offer banking transaction services whilst contributing to The Co-operative Bank's social goal of enabling financial inclusion, albeit indirectly through the co-operative credit union movement. Nine credit unions founded and funded the initial project development and all new entrants to the scheme have to demonstrate their business case to meet the required costs and charges. Unlike other proposals for banking arrangements (see Fuller et al., 2006), in which credit unions merely offer the bank's services to their members, the credit union current account sees credit unions offer their own transactional banking services and accounts, fully under the individual credit union's own control. Simply put, credit unions rent space on The Co-operative Bank's mainframe which enables them to offer current accounts, with Visa ATM and debit cards and functionality for direct debits, standing orders and money transfer.

In November 2006, the banking services project was launched by a pilot group of nine credit unions and ABCUL is currently working with 30 more on the business case for their introduction of current accounts. Among this pilot group was Leeds City Credit Union, perhaps the largest community based credit union in Britain, with over 16,000 members,

[3] BMRB Social Research (2006) revealed, for example, that 51% of respondents from banked households reported that they would go to a bank or building society if they needed money advice. This source of money advice is mostly unavailable to the unbanked even though, in the same research, 20% of respondents without bank accounts cited a bank as a potential source of money advice.

most of whom live in the most deprived areas of the city. Since offering transactional banking services, Leeds City Credit Union has seen a significant take up of accounts particularly by people on welfare benefits, who previously had no access to banking (over 1000 new accounts in the first few months). Furthermore, it has also enabled the social services department and a local charity to open accounts for vulnerable adults and young people who the banks were unwilling to serve.

The introduction of current accounts has been a major advance for British credit unions and takes them one step nearer to becoming full service financial institutions. Yet this is only the first step, the much greater step is managing these accounts in the interests of people of people on low incomes. If they merely replicate basic bank accounts, their purpose will be severely undermined. Even though, as a result of FSA regulation, these new accounts can have no overdraft facility, one clear advantage for account holders is that they can obtain a line of credit within the credit union's normal lending system (either as a fixed term loan or, as introduced increasingly into credit unions, as a revolving credit facility). However, there are other issues to be faced. Collard et al. (2003) have argued that people on low incomes do not use bank accounts, not just because they lack knowledge and trust in banks that have no desire to serve them anyway, but because they prefer the accessibility and financial control that dealing in cash gives them. The challenge for credit unions will be to offer people the kind of current accounts that provide this access and control. This will be demanding on administrative systems and inevitably costly. Already, credit unions are committed to charge substantially lower fees for unpaid transactions than those of the banks (see HCTC, 2006b). Encouragingly, recent research (Jones, 2008) indicates that the majority of low income credit union members are ready to pay a reasonable upfront monthly fee for a transparent and fair current account that they can only access through credit unions.

4.2. Savings accumulation

If the introduction of current accounts was the major step forward in operations, prioritising saving was the sea change in new model organisational culture. Traditionally, acting on poverty meant, for British credit unions, the provision of low-cost loans so that people could free themselves from their dependence on high cost alternative lenders. Yet, as Burger and Zellmer (1995) maintain, focusing first on lending can be like putting the cart before the horse. Borrowing at affordable rather than extortionate rates, certainly maximises income in the short term[4] but, by itself, cannot lead to greater financial stability and independence. It leads only to further dependence on borrowing in the future. On the other hand, building savings, or assets, directly contribute to moving people out of poverty, both economically and psychologically. For one thing, establishing a savings record brings people into an established financial network and often, in credit unions, results in greater access to lending at even lower rates of interest. But, even more importantly, as Sherraden (1991) argued, accumulating savings, or assets, results in a range of positive effects which include planning for the future, health and well-being and increased participation in the community. As he noted, it was incomes that fed peoples' stomachs but it was assets that changed their minds (see Kober and Paxton, 2002).

It is now widely recognised that it is encouraging savings that is the key element in moving people out of financial exclusion (Regan and Paxton, 2001; Bynner and Paxton, 2001; Kempson et al., 2005). Having savings changes the way people feel about themselves and enables them to be more open about the way they use financial services in the future. As Richardson illustrates, "*I remember some sage advice given to me many years ago: 'It's not what you earn that is important, it is what you save'. It is both heretical and hypocritical to talk of poverty eradication without incorporating savings accumulation into the poverty alleviation strategy. The doctrine of micro-savings is the only cornerstone upon which poverty can truly be eradicated*" (Richardson, 2000a). The paradigm shift within new model credit union development was the emphasis on attracting the savings of members (see Richardson, 2000b). In credit union strengthening projects throughout the world, the creation of new deposit accounts which could be withdrawn easily and which received a competitive rate of interest was seen as key not only to the credit union's organisational stability but to enabling people to take the steps towards financial inclusion (Jones, 2004b).

[4] South Tyneside Credit Union's High Cost Loan Replacement Scheme, for example, enabled people to free themselves from the high interest charges charged loans taken out with home credit companies and other sub-prime loans companies. The credit union calculated that providing access to £169,000 of low cost credit has saved beneficiaries over £150,000 in additional high cost interest repayments that would have been paid to alternative lenders typically charging interest rates of around 177% APR (Jones and Rahilly, 2006).

Alternatives FCU, as part of its Credit Path, provides incentives to save by paying a dividend on all accounts with a $5 minimum balance and by offering Individual Development Accounts (IDAs) which encourage saving by providing both a savings match and financial education. A similar approach is increasingly being adopted by British credit unions. Dividends on savings, often not a priority in traditional anti-poverty credit unions, are now planned with accrued funds. Further, following legislative and regulatory changes (HMT, 2002; FSA, 2006), an increasing number of credit unions are offering a range of savings products with variable dividend rates, given the requisite FSA permissions. From 2005, credit unions were able to offer the Child Trust Fund and mini cash individual savings accounts. ABCUL is also currently working with Government to ensure that the Savings Gateway, the equivalent of IDA's in the US, can also be operated by strengthened credit unions, a move supported by the Institute of Public Policy research (Sodha and Lister, 2006).

4.3. Access to affordable credit

Conscious of the millions of people in low income areas, marginalised from mainstream credit (see Kempson et al., 2000) and with little option but to turn to high cost sub-prime lenders, traditional anti-poverty credit unions prioritised lending. They were overwhelmingly borrower-oriented organisations (see Jones, 2003, 2004a,b, 2005). Yet ironically, restrictive lending policies and practices often prevented them from serving people in greatest need (Jones, 2004a). An obligatory twelve week savings period, which preceded any loan application, and the fact that the amount that could be borrowed was limited to twice or three times the amount saved, resulted in credit unions turning away those in need of an instant loan or who were unable to save. These restrictive practices, which were neither legal nor regulatory requirements, arose from traditional custom and practice in most credit unions. It might be argued that the obligation to save, and the linking of loans to savings balances meant that, in reality, credit unions equally prioritised saving. However, this was not the case. For the most part, people saved only to borrow. The widespread policy of not allowing a savings withdrawal, if savings were exceeded by a loan balance, actively deterred borrowers from saving more than they needed to access a loan. In addition, many people saved only the amount they needed to access the size of loan they required.

The modernisation of credit administration was a key element in the reform of British credit unions and is central to new model methodology (see Richardson, 2000a,b; Branch and Cifuentes, 2001; Richardson and Lennon, 2001). For many credit unions, the challenge was to recognise that traditional lending restrictions were unattractive to existing and potential low income members. A range of research reports (Jones, 2001a,b; Collard and Kempson, 2005; Jones and Barnes, 2005) has revealed the specific needs of low income borrowers. These are for access to small loans repayable in cash, for immediacy in decision making, for flexibility and discipline in repayments, for simple and straightforward terms and for familiarity with and trust in the provider, and for confidence that applications will not be refused. Adoption of new model practices resulted in the removal of the link between saving and lending which has enabled credit unions to develop lending policies that are more flexible, efficient and responsive to member needs. Evidence suggests that local community credit unions, properly and professionally organised, are well placed to serve low income borrowers (see Collard et al., 2003). They are able to offer a familiar and local service valued by people unaccustomed to using banks and mainstream financial providers (see Collard and Smith, 2006; HMT, 2007a,b). Instead of restricting a borrower's access to their savings, new model credit unions have been able to minimise risk by introducing effective credit administration and lending based on a capacity to repay. Rather than obliging people to save as a loan condition, maximising savings is achieved by establishing a market rate annual dividend payment and permitting access to savings on demand. In order to provide this more effective service, credit unions had to take the difficult step of raising interest rates on higher risk loans. British legislation restricted credit unions to a maximum interest rate of 12.68% APR or 1% per month on the declining balance of the loan. The interest rate cap was changed by government in 2005 to 25.4% APR or 2% per month (HMT, 2005).

It is still true that modernised credit unions cannot lend to people who cannot afford to repay. In fact, as the Barclays' research demonstrated (Jones, 2003), a loan is not always the best solution to a person's financial situation. Traditional lending, linking loans to a simple multiplier of savings often resulted in credit unions lending to people who could not afford the loan (Jones, 2003). This not only undermined the financial stability of the credit union but also caused greater and longer term distress for the borrower. In supporting vulnerable borrowers, a strategic approach to tackling financial exclusion involves financial capability education and access to money advice.

4.4. Financial capability education and money advice

The Co-operative Bank's research report, "*Would You Credit It*" (Jones and Barnes, 2005), revealed that the myths and uncertainties about the terms, conditions and cost of credit that permeate the social networks of low income communities result in greater financial exclusion (see Meadows et al., 2004). Few people, if anyone, in the research focus groups understood the significance of APR and many judged evidently high cost and over-priced credit products to be reasonable or affordable. Participants had difficulty in understanding the complexities of home credit top up loans, the additional charges levied by weekly repayment retail shops and television meter repayment lenders and, in general, loan applications and credit agreements. The Co-operative Bank research concluded that it was hard to see how any real improvement in tackling financial exclusion could be made without first improving financial capability. Only a small proportion of focus group participants had had any contact with financial capability education or training, in school or elsewhere.

Community credit unions are increasingly regarded as being in a key position to provide financial capability education that would enable members to make informed choices about financial products. "*The bedrock of asset development programs*" argues Williams (2004), "*is financial literacy. Credit unions can help consumers manage financial products effectively, recognize and avoid high cost services, repair credit, and develop savings habits*". Evans and Broome (2005) argue similarly that financial exclusion cannot be improved until financial literacy levels are raised and that credit unions have a key role to play. It was this understanding that led AdFLAG (2000) to recommend that ABCUL work in partnership with the Basic Skills Agency and the Financial Services Authority to develop financial education programmes. Since 2000, a variety of projects have been developed, including, for example, the FSA funded drama project at LASA Credit Union, in Swansea, introducing money issues to children and parents in schools. ABCUL has also worked with the Basic Skills Agency to produce a range of materials for use in credit union financial capability interventions. However, it must be noted that objectively measuring the impact of education and training in raising levels of financial capability is difficult to achieve.

Alongside financial capability education, the Barclay's research (Jones, 2003) highlighted the centrality of money advice in any holistic approach to tacking financial exclusion. A finding supported by Citizens Advice that has urged credit unions to "*work constructively with money advice agencies who are helping people deal with multiple debt problems*" (CA, 2006). In recent years, credit unions have pioneered a range of initiatives to integrate access to money advice within their service delivery. These have included the Money Advice and Budgeting Service, at Enterprise Credit Union on Merseyside (see Brown et al., 2003) and the citizens' advice bureau and credit union partnership in South Tyneside (see Jones and Rahilly, 2006). Building on these initiatives, ABCUL and Citizens Advice have created a new partnership project to bring together face-to-face money advice and affordable financial services in some of the most deprived areas of the country (CA, 2006). Given the differences in their organisational culture and purpose, money advice agencies and credit unions face considerable challenges in forging positive working relationships. The dynamics of these relationships are currently high on the credit union research agenda.

5. The Financial Inclusion Fund – the Growth Fund

Despite earlier disappointments, and based on the continuing transformation of the British credit union movement, there is a resurgence of confidence, in government as elsewhere, in the potential of quality credit unions to achieve financial inclusion within low income communities (see HCTC, 2006a,b). In early 2005, following the publication of the report, "*Promoting Financial Inclusion*" (HM Treasury, 2004), the Government established a Financial Inclusion Taskforce with the purpose of monitoring progress on its policy objectives of tackling financial exclusion. The Taskforce had, within its remit, the oversight of how credit unions, and other third sectors lenders, could be supported to maximise their impact within low income communities. In October 2005, HM Treasury announced a £120 million Financial Inclusion Fund which included a £36 million Growth Fund for credit unions and CDFI's. The purpose of Growth Fund was to expand lending in low income communities and to enable financial excluded borrowers to migrate from sub-prime loan companies into credit union or CDFI membership. Seventy-two credit unions were contracted by the Department of Work and Pensions, and an additional 16 subcontracted by contracted credit unions or CDFIs, to deliver the Growth Fund, which was originally intended to operate from April 2006 for a 2-year period.

The response of the credit union movement to this new government intervention was that "*credit unions need change, not just cash*" (ABCUL, 2005b). The priority for ABCUL was that the organisational reform of recent years was built upon and extended. Unlike public subsidies of the past, which often led to dependency and a lack of growth (Jones, 1999; McKillop and Wilson, 2003; Donnelly, 2004), the Growth Fund was designed not as a grant but as a contract to tackle financial exclusion. Public investment was tied to credit unions operating as professional and market-oriented organisations, to their meeting defined operating standards and to their developing the capacity to make a difference in low income communities. Loans, for example, had to be made on the basis of the new model reforms outlined above and not according to traditional anti-poverty practices.

The Growth Fund has now been in operation about a year and the results are only beginning to emerge. However initial reports are promising. By December 2007, 48,000 loans had been made through the fund to financially excluded people (89% of community finance institutions delivering the fund are credit unions) (HMT, 2007d). Initial success with the fund prompted the government, in March 2007, to provide a further £6 million to support lending in under-served parts of the country, to invest in skills and capacity-building programmes of staff and volunteers and to support credit unions to provide transactional banking services. The support for the introduction of current accounts, as part of the overall approach to tackling financial exclusion, has been particularly encouraging. In addition, in March 2007, HM Treasury announced that it intended to establish a new Financial Inclusion Fund "*for new and ongoing initiatives to promote financial inclusion, maintaining the current level of intensity of action*" (HMT, 2007a). In December 2007, it was confirmed that the Financial Inclusion Fund would be extended until 2011 and a further £38 million made available to credit unions and CDFIs for on lending in financially distressed neighbourhoods (HMT, 2007d).

McKillop et al. (2007) are concerned that such measures as the Growth Fund that provide funds for on-lending are counter-productive in at least two major ways. First, they emphasise credit unions as organisations whose prime mission is to provide financial services to the financially excluded, whereas having a diverse membership is crucial to a credit union's ultimate success. Secondly, he quotes Morris (1999) to the effect that external subsidies do not result in the stabilisation and strengthening of credit unions. In reply, the first concern has already been addressed above; throughout the world credit unions prioritise serving low income communities and are successful so long as they operative on sound business principles and remain attractive to a more moderate income market. The second concern is perhaps the stronger. It is true that credit unions that depend solely on external subsidies for on-lending can become destabilised and vulnerable. This has been a typical experience in many countries of the world (see Branch and Cifuentes, 2001; Jones, 2004b). However, there is no evidence per se that external support necessarily results in a weakening of a credit union organisation. Tansey (2001), for example, illustrates the positive impact of the National Credit Union Administration's community development revolving loan fund and of the National Federation of CDCU's capitalisation programmes on the effectiveness of US CDCUs in low income communities. In fact, unlike the publically funded grant programmes of the past that mainly covered running costs, the Growth Fund is more akin to a capitalisation programme that increases activity in low income communities and, at the same time, strengthens the credit union as an organisation. The majority of Growth Fund investment is capital for on-lending which can be retained as capital in the credit union so long as it is used to serve the financially excluded. Credit unions have to meet strict criteria and delivery targets and to report on financial activity in relation to the supplied capital for at least 10 years. From 2006 to 2007, as a direct result of the Growth Fund, for example, Southwark Credit Union's capital ratio grew from 1.78% to 18.7% (Decker and Jones, 2007). Evidence from the delivery of the Growth Fund is that external support, properly directed and managed, can prompt secure organisational growth in Britain as it does internationally (Arbuckle, 1994; Arbuckle and Adams, 2000; Jones and Goggin, 2007). McKillop et al. (2007), as well as Goth et al. (2006) and Ward and McKillop (2005), base their analysis of the adverse effects of government funding on credit union stability on statistical data drawn from the 2001 credit union financial returns. This was the last year that credit union data was generally available; subsequently the Financial Services Authority adjudged such data as commercially sensitive and that it could no longer be placed in the public domain. The problem is that the 2001 data reflects the credit union movement before its process of transformation and thus reflects the weaknesses of traditional credit unions in low income areas. Certainly, there is always a risk that external funding will result in credit union weakening, but there is no evidence as yet that the Growth Fund has had such an effect. In Southwark, Leeds, South Tyneside, Newham and Hampshire and in many other areas around the country, credit unions are effectively utilising the Growth Fund to make a real difference in providing affordable credit and accessible savings products for low income consumers.

6. Credit unions – a future in serving low income communities?

Recent research has consistently argued that, given the organisational capacity, credit unions are best placed within the financial services industry, to serve those on low incomes (Whyley and Brooker, 2004; Regan and Paxton, 2003). There is certainly little evidence that banks or mainstream providers are interested in serving the low income market. In November 2006, it was reported to the Financial Inclusion Taskforce that there was a clear message from mainstream banks that they "*are unenthusiastic about lending to the financially excluded directly, but are positive about providing support for third sector lenders to increase the scale and coverage of their operations*" (FIT, 2006). Left to its own devices, the commercial market would leave the financially excluded to be served by the numerous alternative and sub-prime lenders that certainly provide access to credit, but at a much higher cost and, often with unfavourable terms and conditions, to low income consumers (Jones, 2001b; Collard and Kempson, 2005). McKillop et al. (2007) have detected correctly that British credit unions are refocusing their efforts to serve those on low incomes. For McKillop et al., this is a concern. However, for many credit unions, it is a social and economic opportunity. There is little evidence that British credit unions are succeeding in the wider mainstream financial market but, as recognised by government, they do have a significant role to play, as co-operative businesses, in providing appropriate financial products suitable for low income consumers.

Nevertheless, it is clear that credit unions do not want to return to the traditional image of the poor person's bank. New model methodology, and the concept of a quality credit union, offers credit unions the opportunity of serving low income and financially excluded groups with the accessible, professional and affordable services and products they need and want. At the same time, as professional, ethical and secure organisations, they can be attractive to more middle-income earners. However, it is true to say that the prevalence of new model or quality credit unions is not yet fully ascertained. For the most part, quality is something that credit unions are striving for through the elements of new model methodology, such as PEARLS financial analysis, capacity based lending, good governance, attractive products and services and a more professional service delivery. Recent research undertaken for the Financial Inclusion Task Force (HMT, 2007e) into the potential and capacity of third sector lenders indicates that about 63 of the 400 community credit unions in Britain demonstrate, or are approaching, the organisational capacity associated with new model or quality credit union development. In addition, 88 credit unions, out of the same 400, were selected by the Department of Work and Pensions to deliver the Financial Inclusion Growth Fund on the basis of new model methodology in regard to lending and of meeting set governance and management standards. It can be estimated therefore that about 15–20% of credit unions operating in low income communities are meeting, or have the potential to meet, new model or quality credit union standards. An additional 28% were identified in the Task Force research as having some potential to meet new model standards. Of course, among some small credit unions, there has been a resistance to change and a lack of aspiration to become new model or quality credit unions (see Brown et al., 2003). In fact, the Task Force research identified 55% of community credit unions has having no or limited potential capacity to serve the financially excluded. The future of many of these credit unions is uncertain. Twenty small credit unions have closed, or transferred engagements to larger credit unions, in the period March 2007 to November 2007 alone.

A critical factor linked to new model development, and the scaling up of the credit union sector, is legislation reform. From the time of the Credit Unions Act 1979, British credit union legislation has been restrictive and has limited growth. ABCUL maintains that the, "Barriers to stop credit unions developing innovative services, expanding into areas without access to credit union services and mobilising savings through convenient methods are enshrined in legislation" (ABCUL, 2007). In June 2007, the government launched a consultation on co-operative and credit union legislation (HMT, 2007c). ABCUL is seeking approval for more flexible common bonds, for institutional membership, for permission to pay interest on savings deposits, for membership for those under 16 years of age, for members to be able to retain membership once they have left the common bond and for greater clarity on the objects of credit unions (HMT, 2007c; ABCUL, 2007). All of which, it argued is central to building the capacity of credit unions to serve low income communities more effectively.

At the end of September 2006, there were over half a million adult members of credit unions in England, Scotland and Wales.[5] These credit unions had assets of over £505 million and a loan book of over £363 million mostly consisting of short term unsecured personal loans. In recent research that focused on 17 credit unions, chosen as representative

[5] FSA aggregate figures in September 2006 recorded 543,359 adult credit union members in Britain.

of the British movement, Collard and Smith (2006) demonstrated how more effective they were becoming in reaching the financially excluded. They found that they were helping people to stop using expensive home credit, encouraging people to save and providing services to people who do not have bank accounts.[6] Given their transformation into quality credit unions, there is every indication that British credit unions will achieve their goal of enabling their members to achieve financial inclusion within low income communities.

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[6] Whilst 7% of the population do not have a bank account, 17% of credit union members do not have one and this figure rises to 29% for credit union members in low income households, with an income of less than £200 per week (Collard and Smith, 2006).

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