

Community finance for London

Scaling up the credit union and social finance sector

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This report was written by Paul A. Jones, of the Research Unit for Financial Inclusion at Liverpool John Moores University and Anna Ellison, Research Director, Policis.

The Research Unit for Financial Inclusion undertakes independent research into issues central to the development of credit unions, co-operatives and social enterprise, and to the future of low and moderate-income consumer finance.

Policis is an independent social and economic research consultancy which focuses on evidence-based policy and service development. Policis financial service practice has particular expertise in credit and the provision of financial services to those on low incomes and a particular research interest in the associated financial inclusion, consumer protection and regulatory issues.

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Foreword

This important research is being published at a very fitting time, both for credit unions in London and in the rest of Britain. Enormous inroads have been made in extending credit union services to the people of London and the rest of the country. All but six London boroughs have complete access to credit union services as do people in over 90% of Great Britain. The Growth Fund has helped many credit unions change beyond recognition and make a real difference in their communities.

But gaps still remain, and many people who can theoretically access credit union services are not within easy reach of a branch or lack a convenient way of making payments or withdrawing cash. In some areas credit unions operate on a limited scale, with a narrow range of services.

Legislative changes have been on the cards for some years, but should come to fruition by the end of the 2011. These vital changes will allow vastly increased numbers to invest in their local communities and benefit from credit union services, including community groups, businesses and social enterprises.

Credit unions won't be so tied to offering services to just one group of people. So by working in partnership with, for instance, housing providers or employers, many more people will be able to benefit from easy access to credit union services, through savings schemes such as pay with rent or payroll deduction.

Credit unions will be able to attract more deposits by offering a guaranteed rate of interest on savings instead of a dividend and so increase the amount of money they can lend. Communities working together will have more potential than ever before to ensure that fair and affordable financial services are available to all.

But getting the legislative and regulatory environment right is just one part of what is necessary for a credit union sector to thrive. As we know from credit union movements around the world, it is by credit unions working together behind the scenes that members benefit through improved value, access and services. That is why the sector is eagerly awaiting the results of feasibility studies which will report to the Department for Work of Pensions later this year, and could see major investment in back office services for credit unions, as well as more investment in the capacity of individual credit unions.

The improved processes that can be put in place when many organisations share resources and technology mean more innovation in service provision and delivery, including quicker and better loan decisions, as well as improved access channels.

So for consumers this could mean joining and using their local credit union at any Post Office branch which is convenient for them. Loans could be pre-approved and applied for at a Post Office branch or at a call centre with opening times convenient for shift workers and those with busy lives.

Improved loan application processes and debt collection resources will speed up the time it takes for a borrower to get his or her money and give credit unions more confidence and ability to make more loans to people on lower incomes in need of credit.

We know from around the world that collaboration is the key to sustainable and effective credit union systems. With the legislation and the infrastructure we need we can look forward to further leaps in the scale and reach of credit unions, and ensure everyone in London and the rest of Britain has access to affordable, accessible and attractive financial services.



Mark Lyonette



Chief Executive Officer
Association of British Credit Unions Ltd.

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Research consultation group members were:

Credit unions: Lakshman Chandrasekera, CEO, London Mutual Credit Union; Jason Herbert, CEO, Lewisham Plus Credit Union; Cheryl Gale, Manager, Hammersmith and Fulham Credit Union; James Richards, Manager, Camden Plus Credit Union; and Mark Lyonette, CEO, Association of British Credit Unions.

Social finance: Corinne Thompson, Professional Development Manager, Community Development Finance Association.

Social housing: David Short, Financial Inclusion Manager, Metropolitan Housing Partnership; Gillian Draper, Project Manager, Southern Housing Foundation; and Jahanara Hussain, Financial Inclusion Manager, The Hyde Group.

Government departments: Catherine Wolthuizen, Team Leader, Consumer Policy, CFEB; and Matt Harris, Head of Financial Inclusion, Saving and Investment, HM Treasury.

DWP: Cath Mitchell, Business Strategy Manager; Yasin Ahmed, and Ross Hume, Strategic Financial Inclusion Champions.

Local authorities: Mark Brangwyn, Head of Community and External Partnerships, London Councils; Chris Norris, Social Enterprise Co-ordinator, London Borough of Lambeth; and Andrew Matheson, Community Engagement, Southwark Council.

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This research report was written by Paul A. Jones, of the Research Unit for Financial Inclusion at Liverpool John Moores University and Anna Ellison, Research Director, Policis.

The opinions, ideas and recommendations contained in this report are those of the authors, based on data generated through the research. They do not necessarily reflect those of any particular participating organisation.

Executive summary

The research study was designed to provide a platform for the development of affordable credit solutions and community finance for London. The study was developed as a collaborative and participative inquiry involving the leading credit union and social finance providers in the capital, and their key partners in central and local government and the social housing sector.

It explores how the credit union and social finance sector might scale up so as to meet the ever-present need for access to affordable credit and financial services that are suited to the needs of those on low and modest incomes. London encapsulates many of the challenges faced by the wider credit union and social finance sector in ensuring community finance contributes significantly to the fight against poverty and worklessness and to the building of strong, inclusive and economically vibrant communities.

The report focuses particularly, but not solely, on credit unions. Apart from one social firm, credit unions are the only community finance organisations engaged in the provision of affordable credit in London. The thinking and solutions proposed in this report are intended therefore as a contribution to the wider policy debate on how most effectively to modernise and scale up credit unions in London and on a national scale.

There is a pressing need for affordable credit in London and for flexible financial services that meet the needs of those on low incomes

London faces a pressing need for affordable credit and financial services. London includes some of the most deprived communities in the UK. Much of inner London is in the top decile of the Index of Multiple Deprivation. Almost a quarter of the housing stock in the capital is social housing, rising to half in some boroughs in East London.

Low-income¹ Londoners differ in profile from those on low incomes in the national population. They are more likely to be in work and less likely to be benefit dependent but nonetheless average household income for Londoners on low incomes, at £11,240 p.a. lags the national average for low income households of £12,175. This is despite being more likely to face higher housing and other costs. Some 27% live in private rented accommodation compared to 17% nationally with low-income Londoners less than half as likely to be home owners as low-income households nationally.

A major feature of the low-income population in London is its ethnic diversity. Some 49% of low-income Londoners describe themselves as white, compared to 86% nationally. Almost a quarter of low-income Londoners describe themselves as black while 16% describe themselves as Asian. Overall ethnic minorities, including white central Europeans, represent 57% of the low-income population in London.

Borrowing is entrenched in the harsh reality of life on a low income and, for many is the only way of managing cash flow and funding major purchases. Some 57% of low-income Londoners are credit users. Credit use is driven by a lack of savings safety nets and competing pressure on budgets that are too tight to manage peaks of expenditure, unanticipated events and high ticket essentials. Some 61% of Londoners have no savings. Three quarters (74%) of Londoners would find it difficult or impossible to raise £200 – £300 in an emergency without borrowing while 83% could find it difficult or impossible to save £500 towards a special purchase.

Credit is less available to low-income Londoners than elsewhere

Patterns of mainstream credit use among the low-income population are similar in London to those elsewhere, albeit that the incidence of mainstream credit use is lower than it is nationally for all mainstream product categories. Where London does appear to differ significantly from the wider low-income population is in patterns of sub-prime credit use, most notably in use of home credit, the leading sub-prime source of cash credit for low-income households nationally.

¹ Defined for the purposes of this study as falling into the lowest 50% of household incomes.

Use of home credit at 3% of the low-income London population, or 115,000 individuals is a little over a fifth of the level that pertains for low-income households nationally. While home credit use broadly follows the distribution of disadvantage it spans a wider spread of communities than the most deprived and is concentrated primarily in low rise estates and outlying suburbs with relatively little penetration in the inner city and in minority ethnic communities. Use of pawn and Cash Converters is similar to national levels but penetration of newer sub-prime credit models such as rent to own and payday lags the national incidence among low-income households. Use of social lending is also much lower than it is nationally. Half as many low-income Londoners borrow from the Social Fund (7%) as is the case nationally (14%) while use of credit unions, at 1% of low-income Londoners, is half that for low-income households nationally. As a consequence low-income Londoners are more reliant on informal borrowing (at 19%) which is almost as important as overdraft finance (22%) and credit cards (21%).

However many low-income Londoners are not able to access credit, with 39% having used no credit in the last five years, rising to 45% of BME households. This compares to the national average of 27%. Eight in ten low-income Londoners believe that they would find it difficult or impossible to borrow £200 – £500 from a mainstream financial institution. More than a quarter of non credit users claim to have had a credit application refused, with half of these being in the last twelve months. This implies that there are 250,000 low-income Londoners with a need to borrow who are unable to do so. Unmet need for credit is reflected in illegal money lending. Some 12% of low-income Londoners are aware of illegal money lending in their own community, rising to 18% in poor white communities. The experience of the London illegal money lending team suggests that illegal lending is also a feature of ethnic minority communities where exclusion is greatest.

There are 0.75m low-income Londoners with a need for affordable credit

Taking together all users of high cost credit and those with a need for credit and not able to borrow we estimate the potential total need for affordable credit to be 0.75m individuals, representing some 30% of low-income Londoners and 42% of social tenants in the capital.

Credit unions are growing rapidly in Greater London but membership remains modest compared with other large conurbations

There are 35 credit unions operating within Greater London; and anyone who lives or works in 27 of London's 33 boroughs can now join a credit union. There are plans to expand credit unions into two further boroughs. Some Londoners can also join a credit union through their employer, local church or association. Throughout London, credit unions are working in partnership with statutory, voluntary and community organisations, with the main partners in London being local authorities and social landlords. This assists in community outreach and enables them to reach particular target groups; and often strengthens credit union capacity to deliver appropriate and affordable financial services.

Credit unions are growing in London faster than they are in Britain generally. In the period 2005 to 2009, credit union assets have grown by 92% (national increase, 44%), loans by 70% (national increase, 36%), savings by 79% (national increase 39%) and membership is up over 90% (national increase, 39%). In 2009, there were around 60,000 members in London credit unions, and, since 2005, membership has been growing at about 18% per annum.

However, to date, even with this growth, credit union membership in London remains modest compared with other large conurbations. It represents about 1% of the total Greater London population; compared with 3% on Merseyside and 5% plus in Glasgow. In areas served by credit unions, membership is strongest in Southwark, Tower Hamlets, Newham, Greenwich and Lewisham.

The DWP Growth Fund has acted as a catalyst for growth and change but highlights also the capacity gaps in credit union coverage in some parts of London

Overall, but with some exceptions, the credit unions that have grown most significantly in London are those that have delivered the Government's Financial Inclusion Growth Fund. Five Growth Fund credit unions more than doubled their membership in the period 2005 – 2009.

Since the start of the DWP Growth Fund in September 2006 and up to March 2011, credit union contractors in London granted over 44,000 loans to people on low incomes and opened over 25,000 current or savings accounts for Growth Fund borrowers. From 2005 – 2009, savings were up 81% in Growth Fund credit unions, compared with 47% in non-Growth Fund live-or-work credit unions.

There is significant variation in the extent to which different credit unions are equipped to grow

The ability of credit unions to expand the provision of affordable financial services depends ultimately on their economic strength, organisational capacity and operational efficiency. Credit unions range from professionally-managed financial institutions, visible in the marketplace with the capacity to offer a range of financial services, to traditional, community organisations often serving a smaller membership base. Membership in individual credit unions in London ranges from just 30 to over 12,000 members.

The major financial challenges facing credit unions lie with achieving cost efficiencies, maximising savings and ensuring effective on-lending

A significant number of credit unions are not yet generating sufficient income to fully sustain and capitalise the business

Expense-to-asset ratios can often be high, and credit unions recognise the need to maximise income and to reduce costs through driving efficiencies in systems and procedures. This can be a major challenge as many credit unions do not yet have the skills, experience or resources to make rapid progress in re-engineering the business. They require high-level technical systems analysis and assistance to drive cost efficiencies.

Most London credit unions still depend to some extent on external financial or in-kind support to meet expenses and to develop the business

With support, credit unions have been able to hire staff, to develop new products and services, to improve IT and to operate out of high-street premises. Overall there is a reducing dependency on external financial support, but some London credit unions are still highly dependent on Government, local government or others to sustain operations and service delivery.

Most London credit unions have controlled bad debt fairly satisfactorily. 87% of Growth Fund credit unions, for example, had less than 10% delinquency on loans, which is regarded as reasonable given the target market. However, controlling bad debt has been highly problematic for some individual credit unions.

Maximising savings will be critical to success and requires a widening of the savings base

Credit unions generate funds for on-lending primarily through attracting the savings of their members. Growth and financial sustainability will require a widening of the savings base. This will involve widening and diversifying the membership profile.

The new credit union legislative reform², expected in 2011, will also offer credit unions a range of new opportunities to maximise savings: these include the introduction of corporate deposits and deferred shares and the ability to pay interest on savings deposits. The importance of the urgent implementation of this new legislation was stressed by all credit union participants.

Nonetheless raising additional funds for on-lending will also need to rest on subordinated loan arrangements and investment by partners and third parties, such as housing associations, local authorities, charitable trusts, and potentially, even, the Big Society Bank. This may be assisted by the possibility of corporate deposits, permissible through the new legislative reform.

² Legislative Reform (Industrial and Provident Societies and Credit Unions 2010).

Effective lending and realistic pricing will be essential to optimise financial stability and ensure that serving high maintenance borrowers can be sustained

For some credit unions, the lending business is not performing at a rate or a size to achieve optimum financial stability. Even with capital funds to on-lend, a credit union requires a sufficiently robust, well-performing business lending model to turn those funds into income. The average loan-to-asset ratio among live-or-work credit unions was around 56%. The World Council of Credit Union recommends that 70% – 80% of assets need to be out on loan in order to achieve financial stability.

High operating expense costs are endemic to serving high-maintenance borrowers with small value loans. This led to a call by credit union managers for greater flexibility on pricing and for raising the interest-rate cap on lending.

Operational and management challenges rest on common vision and focus, partnership and effective use of information technology to support growth

A step change in leadership, governance and management will be needed to drive the movement forward

The expansion of credit union financial services throughout London will entail higher level skills and competencies in strategic planning, organisational management and systems, financial and asset management, credit administration and debt recovery, and human resources. A step-change in the strategic thinking of boards and in the overall competence of management will be needed if credit unions as a whole are to develop as co-operative financial institutions with the capacity to serve large numbers of low and moderate income Londoners.

There is currently significant diversity in product and service offerings and it will be important to develop a common offer while remaining rooted in local communities

Variations in approach and capacity have resulted in credit unions offering products and services that are often dissimilar from one another. This diversity has led to inconsistencies in quality of product and service delivery. As a result partner organisations can feel that there is no single clear message that can be communicated about the benefits of joining and using a credit union.

Refocusing the credit union business to serve a wider target market will be critical to the ability to serve those traditionally excluded

Too narrow a focus on those on very low incomes is not sustainable within a growth strategy. All credit union managers interviewed were keen to refocus the business to serve a wider segment of the low and moderate income market. Credit unions now rather aimed to be inclusive financial providers, with those historically excluded from the financial services sector served alongside a wider range of members.

Developing information technology will be key to effective financial management and growth

Credit unions need to invest in information technology to ensure the effective credit assessment of loan applications, the control of bad debt and the management of loan portfolios, as well as the computerisation of administrative information systems. They also need to introduce online access and card services which are now standard throughout the financial services sector. Many individual credit unions, however, have limited resources to make significant advances in upgrading information technology.

Effective partnerships with a range of partner organisations will be key to scale and engagement with communities and local economies

Credit unions, together with other social lenders, have the potential to collaborate with local authorities, social landlords and others in building prosperous, vibrant and cohesive communities. In turn, local authorities and social landlords have an important supportive role in enabling their development. Local authorities and social landlords increasingly expect credit unions to be organisations with which they can do business, and require consistency in product quality and service delivery as a pre-condition of partnering with credit unions to widen access to affordable financial services.

The future is collaborative: the challenge of radical change

This study strongly argues that there is a compelling case for a move away from an atomistic business model to one based on collaboration and shared services. It is collaboration that offers a real opportunity to build scale and efficiency in the sector whilst maintaining the community finance ethos and vision that defines and differentiates it from the mainstream.

The way forward in expanding access to credit union financial services lies in greater credit union collaboration and in the development of a cohesive and comprehensive system of shared services.

Collaboration enables credit unions to gain economies of scale, to improve the efficiency and effectiveness of operations and service delivery, to enhance brand recognition and strategic marketing and, importantly, to enable smaller credit unions to offer the same level of service as larger institutions. It presents a radically new approach to the business and calls for a cultural shift in the way boards and managers think about operations. The focus is on commonality rather than uniqueness; and on operational excellence in credit union service delivery.

Recommendations

The report contains a comprehensive list of recommendations for the credit union sector, Government and partner organisations. The following are key headline recommendations:

Credit unions in London should:

- Recognise, in common with many credit union movements world-wide, that long-term success in expanding credit union financial services depends on the development of a collaborative credit union system and that without collaboration, there will be no real future for the movement in London as a meaningful provider of affordable financial services on any scale.
- Seek to widen their target market and prioritise the development of a wider range of financial products and services which meet the needs of low and moderate income working people, and which attract a broader range of people to join credit unions.
- Introduce modern electronic delivery channels for financial services in London. These would include internet and telephone access, SMS and mobile phone technology, and card services with ATM access and debit card facilities.
- Focus on the development of enhanced financial management skills and the highest governance standards. Weak and vulnerable credit unions should be encouraged to transfer engagements into stronger credit unions to benefit from collaboration and protect the integrity of the movement in London.
- Transform operation efficiency through taking a lead in ABCUL's new back office project and their initiatives on collaborative credit assessment and debt recovery as the means to achieve both short term wins and long term collaboration.
- Pioneer the link with the Post Office, which has the potential to open up access to credit union products and services to a wider population in London.
- Work with Central and Local Government, social landlords and other agencies to build an increasingly modernised and professional credit union movement in London and to revitalise and strengthen local communities.

This aim of this research study was to investigate access to affordable credit through community finance organisations in Greater London, to identify those areas where a gap exists between existing supply and demand, and to analyse the potential of existing providers to expand provision. The research is an action-oriented study and its findings, conclusions and recommendations are intended to provide strategic direction and a blue-print for change to assist the community finance sector to scale up to meet the ever-present need for access to affordable credit and financial services among those on low and moderate incomes in the capital.

The framing of the aims of the research reflect the concerns of its originators to strengthen the reach of the community finance sector in low-income communities and to ensure that the momentum created by the Financial Inclusion Growth Fund would be continued after it ended in March 2011. The original research focus was on scaling up access to affordable credit in London and, therefore, the data analysis in Section 1 of the study concentrates entirely on the provision of credit. However, as the study progressed, it was clear that if the community finance sector was to assist people on low and moderate incomes to achieve financial stability, access to savings, transaction accounts, money and debt advice and other financial services would be critical to success. For this reason, as it progresses, this report is about community finance for London, and not just access to affordable credit.

The framing of the aims of the research reflect the concerns of its originators to strengthen the reach of the community finance sector in low-income communities

In reality, the study has focused primarily on the credit union sector. There are no community development finance institutions (CDFIs) offering consumer finance in London. Those that exist are involved in business and enterprise lending. So apart from one social firm, credit unions are the only community finance organisations engaged in the provision of affordable credit in London. As this report reveals, they now serve over 60,000 members, are open to all who live or work in 27 of London's 33 boroughs; and are accessible to some Londoners through their place of work, local church or association. In comparison, the one social firm offering consumer credit serves 1,000 borrowers, 65% of whom are to be found in two London boroughs.

The study is focused on London, which although a vibrant, thriving world-class city, also contains some of the most deprived and financially excluded areas of the UK. London encapsulates many of the challenges facing the Government and the credit union and social finance sector seeking to grow access to affordable credit, and to embed community finance more broadly in the effort to fight poverty and worklessness and to build strong, inclusive and economically vibrant communities. In fact, the conclusions and recommendations of the report have, therefore, a far wider import than within London alone and are of significance for the entire credit union and social finance sector.

At the time of writing, credit unions in London, as elsewhere, have reached a critical point in their evolution. The Coalition government is seeking to build on the achievements of the credit union sector through a new drive to modernise and scale-up service provision in order that it may serve many more people on low and moderate incomes. The challenges are great, but, as has emerged in this report, a clear way forward is possible through the development of a new collaborative model of development. The credit union movement has transformed itself significantly over the years and, the report argues, has the capacity for even greater change in the future. It only requires the will to make change happen.

This first chapter of the report describes how the project team approached the project and developed the thinking with stakeholder partners. It then explores the demand environment and the need for affordable credit in London, and the fit with existing social lending supply. Later chapters describe the supply side dynamics and recommendations for ways forward in the strategic development and scaling of the credit union and social finance sector in London and more broadly.

Approach and methodology

Approach

This study was developed as a collaborative and action-oriented inquiry involving the leading credit union and social finance providers in the capital and their key partners in the DWP, local government and the social housing sector. Active engagement in the research has been through the constitution of a consultation group and through a series of in-depth interviews with key players and partners in the provision of affordable financial services in London,

The overall conviction was that the research would lead to a blue-print for action and for the future development of the community finance sector in London. The focus throughout has been on change and transformation of the sector in the interests of people with a need for affordable credit and other financial services in London.

From this perspective, whilst the study brings together evidence from both supply and demand side research to inform the deliberations of the consultation group and project team, much of the thinking that shaped the study and the recommendations that flow from it, was undertaken in the consultation group discussions and is based on many detailed comments from a range of stakeholders on early drafts of various report chapters. The report that has resulted from this process is thus a collaborative, consensual vision of the way forward for the sector in London.

Methodology

The consultation group met on a number of occasions, at the outset of the project to discuss the aims and proposed methods, and at various points to discuss key research outputs and their implications for development and to comment on drafts of the report and recommendations. Various iterations of draft chapters and the completed report were subsequently considered by individual members of the consultation group and key stakeholders, including leading London credit unions, representatives of the credit union and CDFIs trade bodies, ABCUL and the CDFA, and representatives of the DWP, local government and social landlords. The resulting comments then shaped the final report and recommendations.

The consumer perspective and the need for affordable credit

The demand-side research for affordable credit in London rested on the following work-streams:

- Secondary analysis of quantitative consumer research data from two Policis studies (Ellison et al., 2010, 2011), originally funded respectively by HM Treasury and the Friends Provident Foundation, with underlying survey data collected by GFK NOP in 2010. The data was derived from a survey of patterns of credit use among a nationally representative random sample of 1,511 low-income consumers, defined as being in the lowest 50% of household incomes³, with an additional boosted sample of 350 unbanked and newly banked individuals. A sub-set of 246 low-income Londoners within this sample was further analysed to inform this study.
- Analysis and geo-spatial mapping of the Government index of multiple deprivation at super output area level for all of the Greater London boroughs, combined with Policis data on total financial exclusion, defined as those areas not served by even the highest cost private sector lenders, itself derived from anonymised, aggregated customer data for London at post code level, provided by the major home credit companies.

³ Consumers living in households where monthly pre-tax household income was £2,025 or less, defined as the median household income in Effects of Taxes and Benefits on Household Income 2007/8, HRMC July 2009 (Table 24 – Appendix 1).

Much of inner London is in the top decile of the index of multiple deprivation

- Analysis at post-code level of aggregated anonymised London-based home credit customer data level provided by the major home credit companies, to enable the geo-spatial mapping of the distribution of home credit customers across the capital.
- Information on the geographical distribution of arrests and victims of illegal lending, provided by the London Illegal Money Lending team as part of Policis Mid Term Evaluation of the National Illegal Money Projects, 2010 and reproduced with permission. This was complemented by Policis survey data on illegal lending, drawn from the consumer research referred to above, which also fed into the BIS evaluation.

The lender and stakeholder perspective

The research focused on the supply of affordable credit and other financial services as offered through the community finance sector. In London, this is characterised by credit unions and just one social firm. There is no CDFI consumer lending in London.

The supply-side research underpinning the project rested on the following research work-streams:

- In depth interviews undertaken in fifteen London credit unions, with CEOs, managers or board members plus the manager of the one London social firm involved in consumer lending (see list in appendices). The interviews included all the credit unions which delivered the Financial Inclusion Fund Growth Fund.
- Three research workshops to support reflective enquiry with social landlords and with financial inclusion champions working with credit unions.
- In depth interviews with stakeholders, including registered social landlords, local authority staff, DWP, FSA, CFEB and the CDFA.
- Ongoing liaison with ABCUL, the credit unions' trade body, and with all of the members of the consultation group throughout the life of the project.
- Financial analysis of lending and other financial statistical data of the fifteen participating London credit unions using the World Council of Credit Union's PEARLS financial monitoring system. This was complemented by analysis of the annual financial returns of each of the credit unions.

The demand for and supply of affordable credit across London

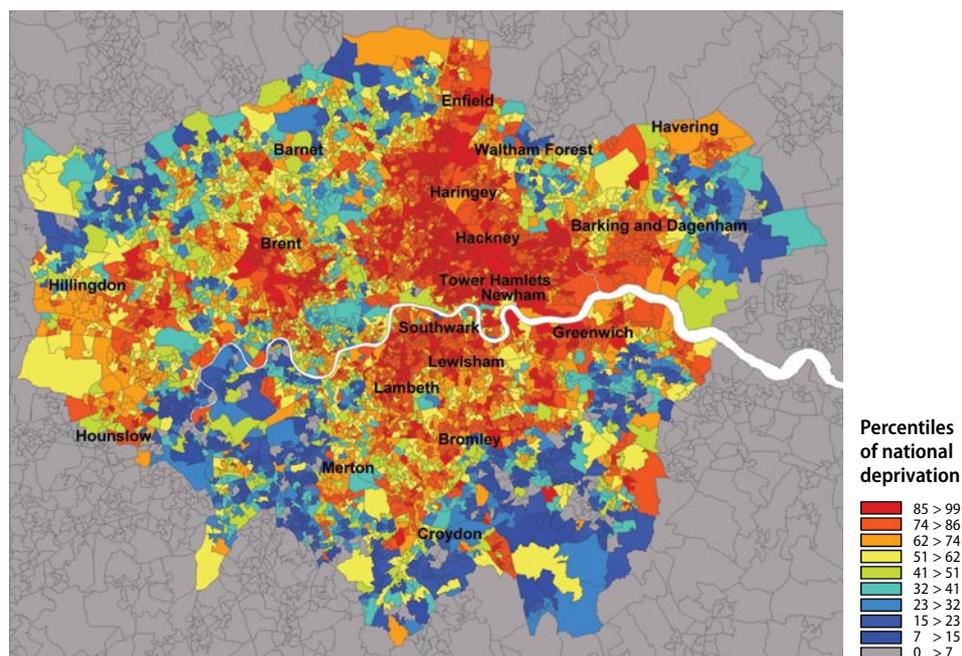
1.1 Concentrations of poverty in the capital

London includes some of the most deprived communities in the UK. Much of inner London is in the top decile of the index of multiple deprivation with an arc of disadvantage stretching from the North to the East, being heavily concentrated in East London, around Haringey, Hackney, Newham and Tower Hamlets. There is a further cluster of intense deprivation in the West around Brent and a further cluster in the South around Southwark and Lambeth.

Almost a quarter of the housing stock in the capital is social housing, rising to half in some boroughs in East London. Half of all social housing stock is concentrated in a quarter of London wards. The map of greater London, shown in Figure 1 below illustrates the relative concentrations of poverty and disadvantage and their geographical spread across the capital.

Figure 1
Much of inner London is in the top decile of multiple deprivation with an arc of disadvantage from North to East and extending to the central area in the South

Index of multiple deprivation – Greater London



Low-income Londoners are more likely than those on low incomes living elsewhere to be low paid workers

Financial pressure is a fact of life for many low-income Londoners (defined for this purposes of this report as those in the bottom 50% of household incomes). A little over one in ten (11%) have faced problems providing food for the family in the last twelve months, rising to 15% of low-income minority ethnic Londoners. Some 28% have faced problems affording electricity, gas or heating, rising to 35% of low-income minority ethnic Londoners. Some 22% have faced difficulties affording shoes and clothing, rising to 24% among minority ethnic groups. Some 13% of low-income Londoners have faced difficulties in affording rental payments, rising to 16% of minority ethnic groups. Almost one in five (19%) of low-income Londoners are in arrears on household bills.

1.2 Profile of low-income Londoners

Low-income Londoners however differ in profile from those in the national population of those on low incomes. Low-income Londoners are more likely than those on low incomes living elsewhere to be low paid workers, as distinct from being benefit dependent. Nationally, some 45% of those in the lowest 50% of household incomes are benefit dependent, compared to only 35% of the same income range in London. A third (33%) of low-income London households have at least one full time worker, with a further 13% having two or more full time workers. One in five (19%) low-income London households contain part time workers, including those with multiple part time jobs. Despite this, however, the average household income for low-income Londoners is a little over £11,240 p.a. or £935 p.m., lower than the national average for households in the bottom 50% of income households, of £12,175 p.a., or circa £1,015 p.m.

Figure 2
Employment profile of low-income households, nationally and London

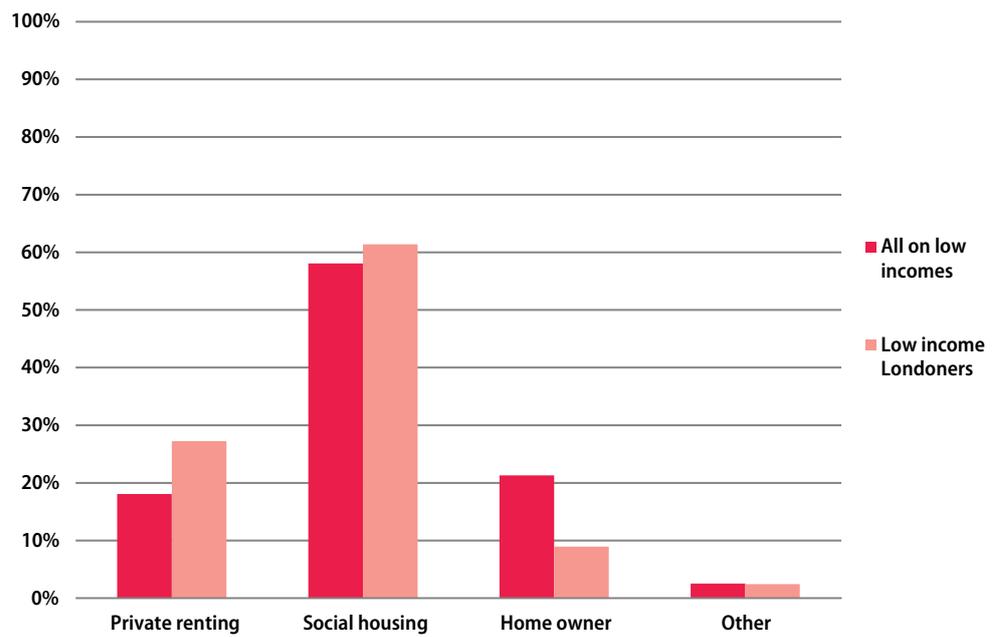
Low income Londoners not only have lower incomes than those on low incomes elsewhere, they also face higher housing and other costs



Base: Lowest 50% of household incomes. All on low incomes 1886. Low-income Londoners 264.

Low-income Londoners not only have lower incomes than those on low incomes elsewhere, they also face higher housing and other costs. Low-income Londoners are more likely than other low-income households to rent privately and less likely to own their own homes. A little over six in ten (61%) low-income Londoners live in social housing, close to the national average at 58%. However, a little more than a quarter (27%) live in private rented accommodation, significantly higher than the national average for the same income range, at 17%. Some 9% of are low-income Londoners are home owners, less than half the national average for those on low incomes, of 21%.

Figure 3
Tenure profile of low-income households, nationally and London

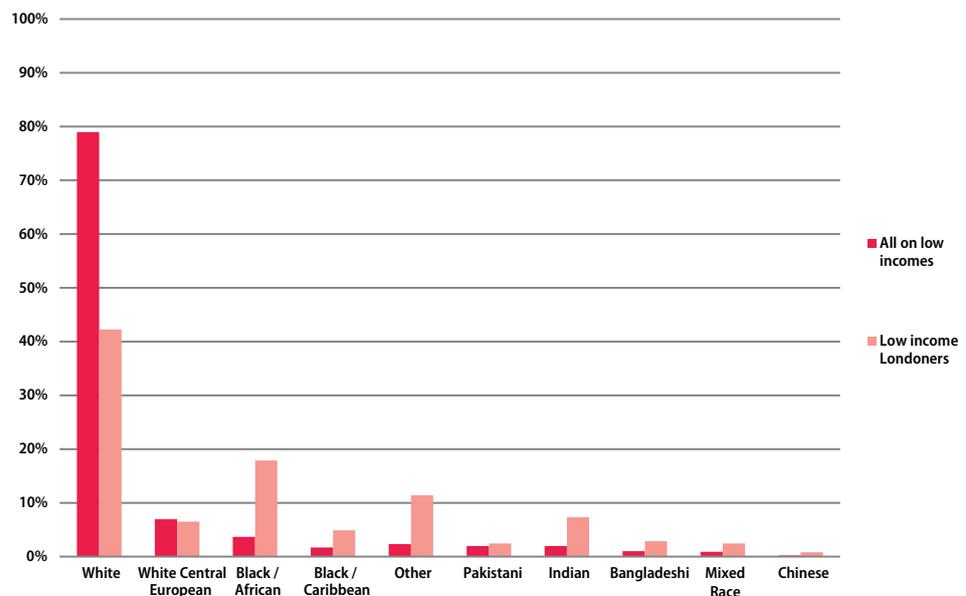


Base: Lowest 50% of household incomes. All on low incomes 1886. Low-income Londoners 264.

A major feature of the low-income population in London is its ethnic diversity. Nationally, 86% of people living in low-income households describe themselves as white, compared to 49% of low-income Londoners. Almost a quarter (23%) of low-income London residents describe themselves as black while 16% describe themselves as Asian. Some 7% of the low-income London population describe themselves as White Central European. Overall ethnic minorities represent 57% of the low-income population in London.

A major feature of the low income population in London is its ethnic diversity

Figure 4
Ethnic diversity profile of low-income households, nationally and London



Base: Lowest 50% of household incomes. All on low incomes 1886. Low-income Londoners 264.

1.3 The need for affordable credit

In discussing the need for affordable credit in London and the role of credit unions in tackling the impact of poverty and widening access to quality financial services, it is important to recognise the centrality of credit to the budgets and finances of those on low incomes, in London as much as elsewhere.

Credit use among low-income households is widespread and unlikely to go away any time soon. Borrowing is entrenched in the harsh reality of life on a low-income and, for many, is the only way of managing cash flow and funding major purchases. Credit use is driven by a lack of savings safety nets and competing pressures on budgets that are too tight to manage peaks of expenditure, unanticipated events or the purchase of high ticket essentials.

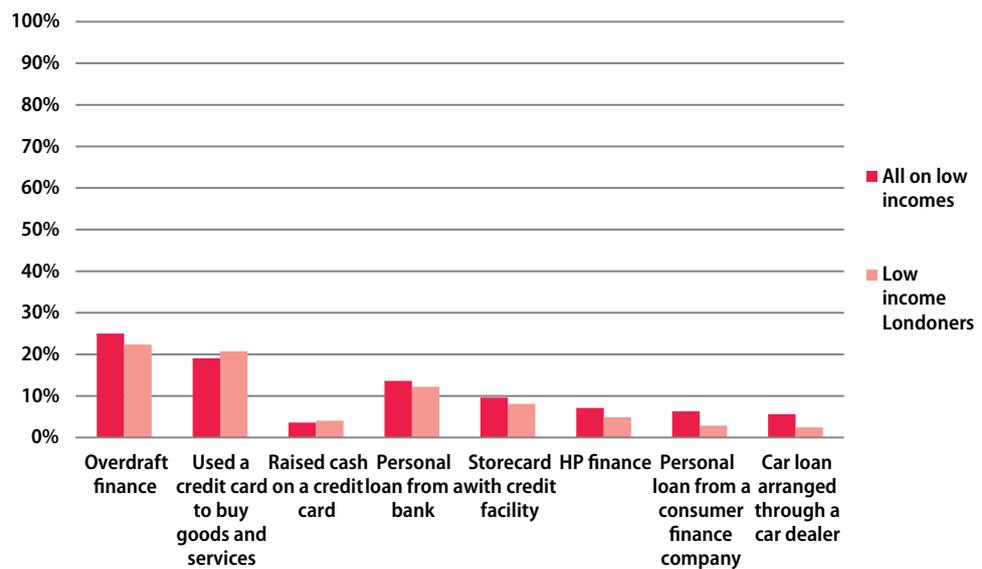
In London only 61% of those on low incomes have savings, and among those who do, savings are low value, with very few having savings on a scale that would preclude the use of credit. Among low-income Londoners with savings, the average savings value is a little less than £250. Three quarters of low-income Londoners (74%) would find it difficult or impossible to raise £200 – 300 in an emergency without borrowing while more than eight in ten (83%) would find it difficult or impossible to save £500 towards a special purchase.

Nationally, almost seven in ten low-income households are credit users, with almost two thirds of those on low incomes using commercial private sector credit. In London, credit use at 57%, is lower among low-income households than it is nationally. As will be discussed in this section, this is for a mix of both demand and supply side reasons.

1.4 Mainstream credit use by low-income Londoners

Low-income Londoners have less access to both mainstream and sub-prime credit than low-income households elsewhere. As in the wider low-income population, credit use among low-income Londoners focuses primarily on mainstream credit products, with overdrafts and credit cards, used by 22% and 21% of low-income Londoners respectively, being the leading sources of credit. Some 12% have taken out a personal loan from a bank and 8% use store cards and 5% use HP finance. Some 3% have taken on a personal loan from a consumer finance company and 2% have taken on a car loan through a dealer. Some 4%, around one in five of card holders, raise cash advances on a credit card. Overall this pattern is in line with that of the low-income population nationally, albeit that incidence is a little lower in most product categories than elsewhere.

Figure 5
Mainstream credit use all on low incomes and low-income Londoners

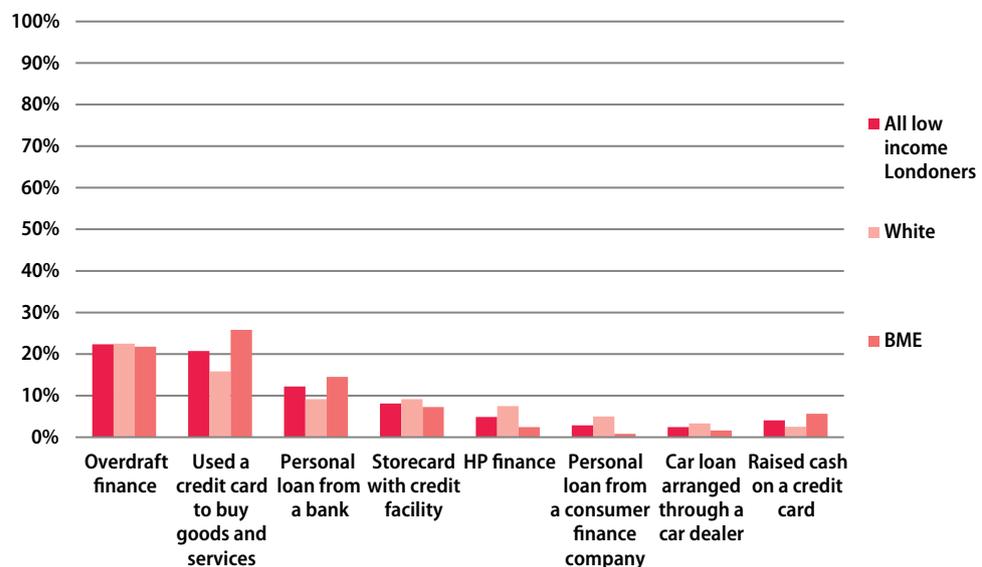


Base: Lowest 50% of household incomes. All on low incomes 1886. Low-income Londoners 264.

There do appear to be quite marked differences between ethnic groups in their use of credit products, both mainstream and sub-prime. Generally, low-income Londoners in ethnic minorities appear to be more likely than their white counterparts to use credit cards and to take out personal loans from the bank. Low-income white credit users, by contrast, are more likely to use credit vehicles at the more expensive end of the mainstream spectrum such as HP finance, personal loans from consumer finance companies and store cards.

Three quarters of low-income Londoners would find it difficult or impossible to raise £200-300 in an emergency without borrowing

Figure 6
Mainstream credit use low-income Londoners by ethnicity



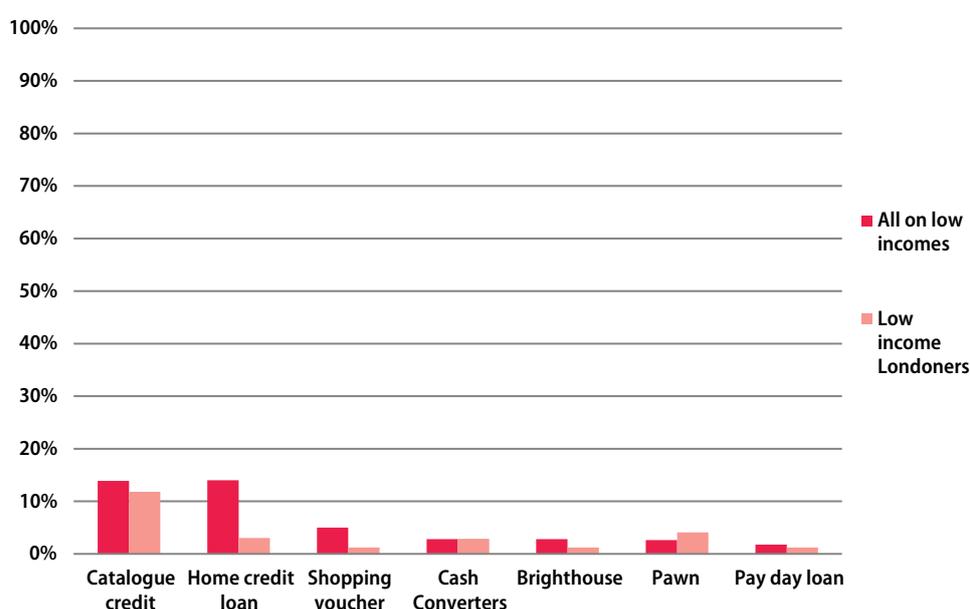
Base: Lowest 50% of household incomes. All on low incomes 1886. White 120. BME 124.

1.5 Patterns of high-cost credit use across London

Where London does appear to differ significantly from the wider low-income population is in patterns of sub-prime credit use. The major difference between the capital and low-income communities elsewhere lies in the low incidence of home credit use, used by only 3% of Londoners compared to 14% nationally. Shopping vouchers similarly are used by 5% of low-income households but only 1% of low-income Londoners. Partly as a result, catalogue use among white low-income households, at 18%, is significantly higher than among the national low-income population at 12%, though it is much lower among ethnic minority households, at 6%. Use of pawn-broking and Cash Converters appears similar to national levels while penetration of newer credit models such as Brighthouse and payday appear to lag the national incidence⁴.

Figure 7
Sub-prime and high-cost credit all on low incomes nationally and low income Londoners

Almost eight in ten low-income Londoners believe that they would find it difficult or impossible to borrow £200 - £500 from a mainstream bank or loan company

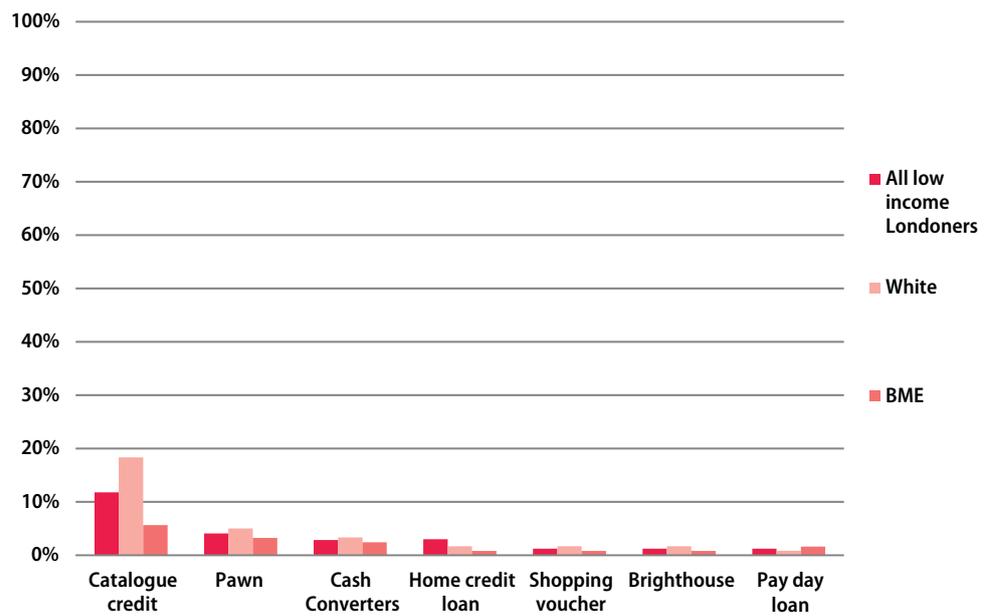


Base: Lowest 50% of household incomes. Low-income Londoners 264.

Generally, low-income ethnic minority households appear to be less likely to use high-cost sub-prime products across the board. Low-income black households in London, however, appear more likely than other BME groups in the capital to use both pawn and payday loans.

⁴ These patterns appear driven not by demand but by supply side factors, with home credit lenders tending not to serve areas with high concentrations of tower block housing, most typical of deprived inner London, on the grounds that such housing has posed both safety and collection challenges. More recently newer sub-prime lenders have tended to launch and focus their early drive for growth in deprived urban conurbations in the North.

Figure 8
Sub-prime and high-cost credit use low-income Londoners by ethnicity



Base: Lowest 50% of household incomes. All on low incomes 1886. White 120. BME 124.

The strikingly low incidence of home credit in the capital bears further examination as it is highly relevant to the concentrations of need for affordable credit in London.

Examination of published home credit provider data and reports and accounts suggests that Londoners represent less than 5% of all home credit customers, implying an estimated 115,000 home credit users in Greater London. Examining home credit users' geographical distribution on the basis of customer postcodes derived from aggregated home credit provider data shows that while home credit use broadly follows the pattern of disadvantage across London, home credit users are to be found in a much wider range of communities than the most deprived. Indeed the profile of users is biased towards white communities and low-rise estates and is strongly represented in the outlying suburbs, while being under-represented in areas with high concentrations of minority ethnic communities and in tower block housing.

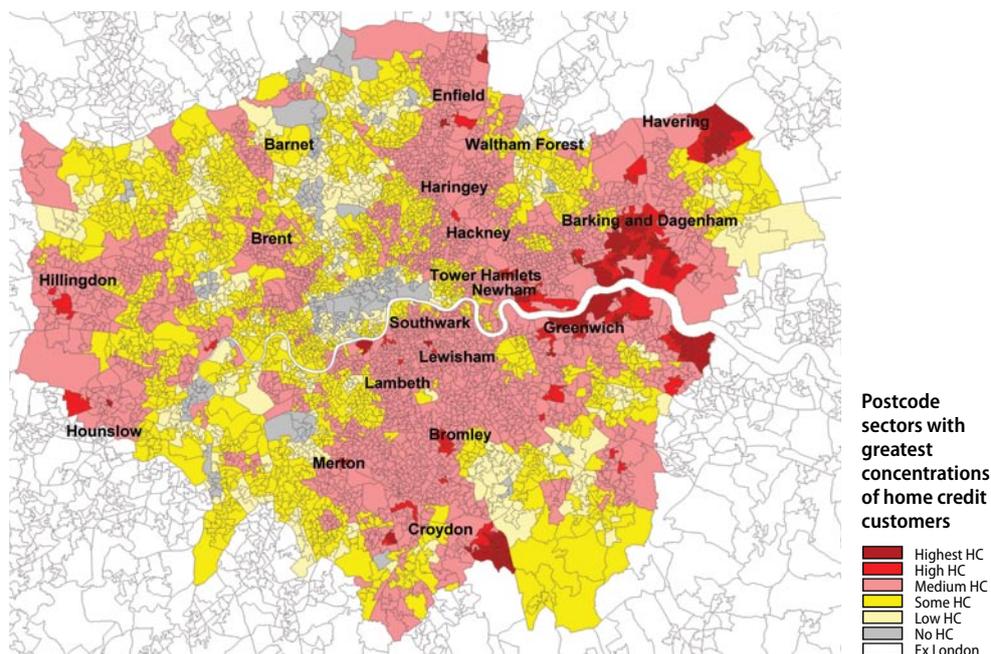
Taking together the overall patterns of high-cost credit⁵ use among low-income households, we estimate that there are approximately 0.5m low-income high-cost credit users across the capital.

Low-income Londoners have less access to both mainstream and sub-prime credit than low-income households elsewhere

⁵ Defined as home credit, shopping vouchers, payday lending, pawn, Cash Converters and Brighthouse

Figure 9
High-cost credit use broadly follows pattern of disadvantage but is found in wider range of communities

Concentration of home credit use – Greater London



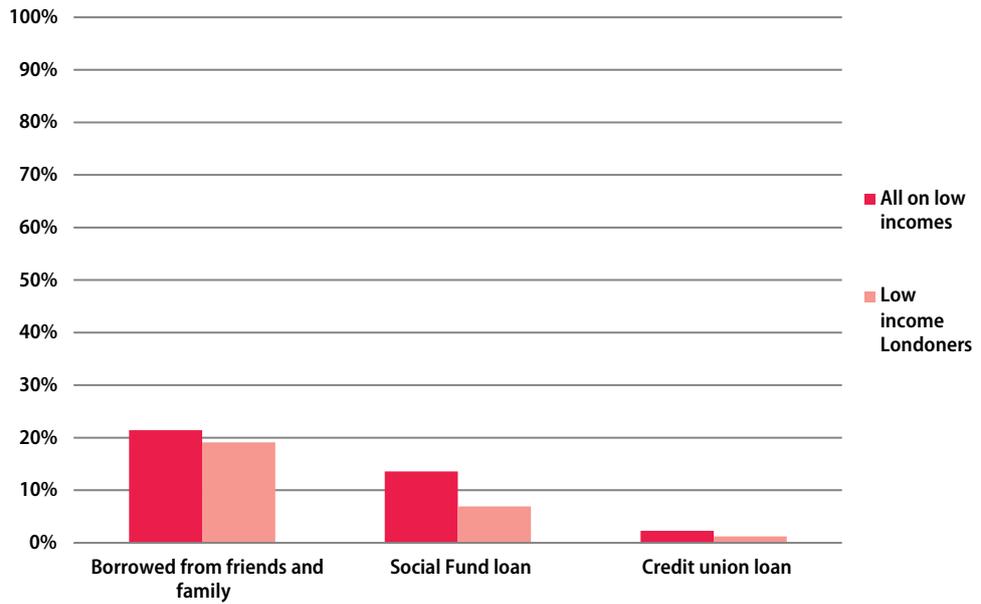
1.6 Social lending and informal borrowing

Low-income Londoners are also less likely to have access to social lending than low-income households elsewhere. Half as many low-income Londoners (7%) borrow from the Social Fund than among the low-income population nationally, where 14% use the Social Fund. A similar pattern prevails for credit union use, which at 1% of the low-income population in London is half that nationally, at 2%. As a measure of the extent to which credit union use in London lags that in other major conurbations it is perhaps worth noting that by comparison, some 3% of the population on Merseyside and over 5% of the Glasgow population are credit union members (See Section 2.1)

The relatively low levels of both private and social sector borrowing are reflected in relatively high levels of informal borrowing, which remains a key source of credit for low-income Londoners. One in five (19%) low-income Londoners borrow informally from friends and family, very close to the levels of use of the leading mainstream credit products, overdrafts and credit cards (as noted earlier, 22% and 21% respectively).

Figure 10
Informal and social borrowing

All on low incomes nationally and low-income Londoners



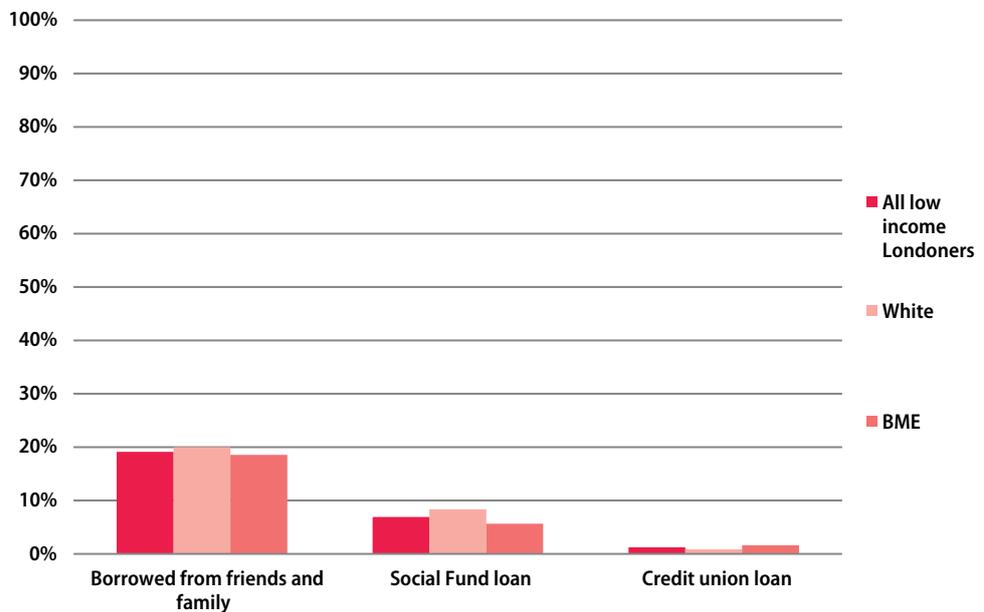
Base: Lowest 50% of household incomes. Low-income Londoners 264.

It is perhaps worth noting that there is very little difference between white and BME low-income Londoners in their patterns of use of either informal or social lending.

There would appear to be a significant unmet need for credit among low-income Londoners

Figure 11
Informal borrowing and social borrowing

Low-income Londoners by ethnicity



Base: Lowest 50% of household incomes. All on low incomes 1886. White 120. BME 124.

1.7 Unmet need for credit

Taking these patterns together, there would appear to be a significant unmet need for credit among low-income Londoners. Indeed, low-income Londoners would appear to have fewer credit options than those on low incomes elsewhere.

Four in ten (39%) of low-income Londoners, rising to 45% of BME Londoners, have used no credit in the last five years, compared to 27% in the same income range in the national population. The majority (75%) of non credit users do not use credit as a choice, with these non credit users being primarily older, single and more likely to belong to an ethnic minority.

Of those low-income Londoners who have not used any credit in the last five years, a quarter (25%) claim to have at least an occasional need to borrow, with these frustrated borrowers being primarily younger and more likely to have children, and more likely to be white (30%) than from a minority ethnic background (16%).

This picture of unmet demand for credit would seem held out by the fact that more than a quarter of non credit users claim to have had a credit application refused, half of these refusals reportedly being within the last twelve months.

Almost eight in ten low-income Londoners believe that they would find it difficult or impossible to borrow £200 - £500 from a mainstream bank or loan company. A quarter of low-income Londoners take the view that they would find it impossible to do so, with a further 53% believing that they would find it difficult.

Against this background, it is worth noting that the most disadvantaged inner city and in minority ethnic communities do not appear to have access even to the high-cost home credit which is so important a component of the credit use of low-income communities elsewhere in the UK.

On this basis we estimate that there are approximately 250,000 low-income Londoners with a need for credit and who are unable to borrow. One of the barriers to credit union growth has been a lack of awareness of credit unions. Some 62% of low-income Londoners who have a need to borrow and who have no source of credit say that they are not aware of credit unions, with a further 8% saying that they would not know how to go about getting a credit union loan.

Some 62% of low-income Londoners who have a need to borrow and who have no source of credit say that they are not aware of credit unions

1.8 Illegal money lending

Unmet need for credit is reflected in illegal money lending, as evidenced by the increase in illegal money lending as the supply of legitimate credit has shrunk following the financial crisis, particularly in the most deprived communities⁶. Use of illegal money lending is concentrated almost exclusively among those who have no access to legitimate credit.

Nationally, some 2% of low-income households, rising to 6% of those living in the most deprived communities, use illegal money lenders⁷. Some one in twenty (5%) of low-income borrowers refused credit claim to have turned to a loan shark. More than one in ten (12%) of low-income Londoners are aware of illegal money lending in their own community, rising to 18% of low-income white Londoners.

Illegal money lending operations are frequently underpinned by intimidation and violence. The cost of credit from such lenders averages more than three times that of the highest cost legitimate credit⁸. The experience of the London illegal money-lending team suggest that there is a wide range of illegal lending models operating in the capital, ranging from the relatively less harmful with comparatively transparent pricing underpinned by pester power

⁶ Source: Policis for BIS Mid Term Evaluation of the National Illegal Money Lending Project 2010

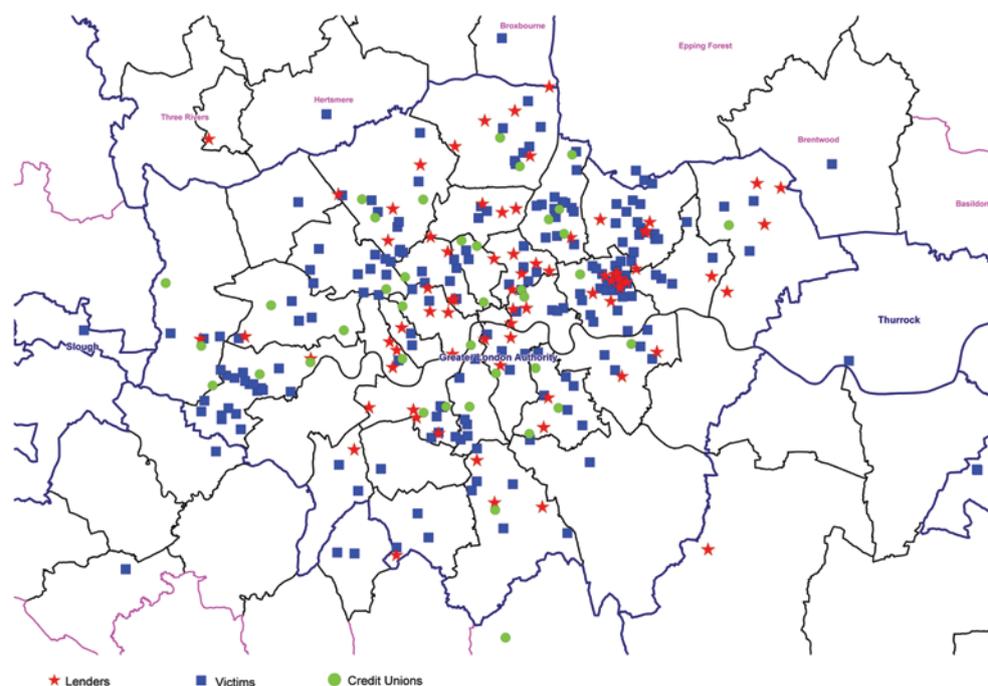
⁷ Source: Policis for BIS Mid Term Evaluation of the National Illegal Money Lending Project 2010

⁸ Source: Policis for BIS Mid Term Evaluation of the National Illegal Money Lending Project 2010 and Policis and PFR for DTI "Illegal Lending in the UK", 2007

and implied threat to the deeply exploitative and ultra-violent, with close connections to organised crime⁹. Intelligence and patterns of arrests and the distribution of victims suggests that many of the illegal lending operations concentrated in the capital are focused within ethnic minority communities. The map following as Figure 12 which plots concentrations of arrests and victims across Greater London indicates that lending appears to be concentrated in those areas of East and North London where credit exclusion is greatest.

Figure 12
In London much of illegal lending concentrated in areas of credit exclusion – notably in ethnic minority communities

IML map of victims, lenders and credit union locations, 2010



*More than one in ten
 (12%) of low-income
 Londoners are aware of
 illegal money lending in
 their own community*

Source: London Trading Standards Illegal Money-Lending Team

1.9 Estimated need for affordable credit in London

There are a number of ways in which to approach arriving at an estimate of the need for affordable credit in London and the demand dimensions of the effort to scale credit union lending in London and more widely. Essentially this is a matter of market definition.

One approach might be to take together those who have a need to borrow and who have no access to credit and those who are currently users of high-cost credit. On this basis we would estimate the potential total need for affordable credit to be 0.75m individuals, representing some 30% of low-income Londoners and 42% of social tenants in the capital.

One of the challenges for credit unions however, as is argued later in this study, is to grow their appeal and widen their target market beyond the financially excluded to a broader spectrum of those on low and modest incomes. There is an opportunity for credit unions to offer not only affordable credit but a wider range of quality financial service products to those on low incomes and, indeed, to attract customers from the banks to a vibrant new credit union sector.

⁹ For further details and descriptions of the various lending illegal money lending models please see Policis study for BIS "Mid Term Evaluation of the National Illegal Money Lending Project" 2010 and our earlier studies for DTI "Evaluation of the Illegal Money Lending Pilot Projects" 2007 and "Illegal Lending in the UK", the latter undertaken with PFRC, University of Bristol.

1.10 Community finance supply and the fit with need

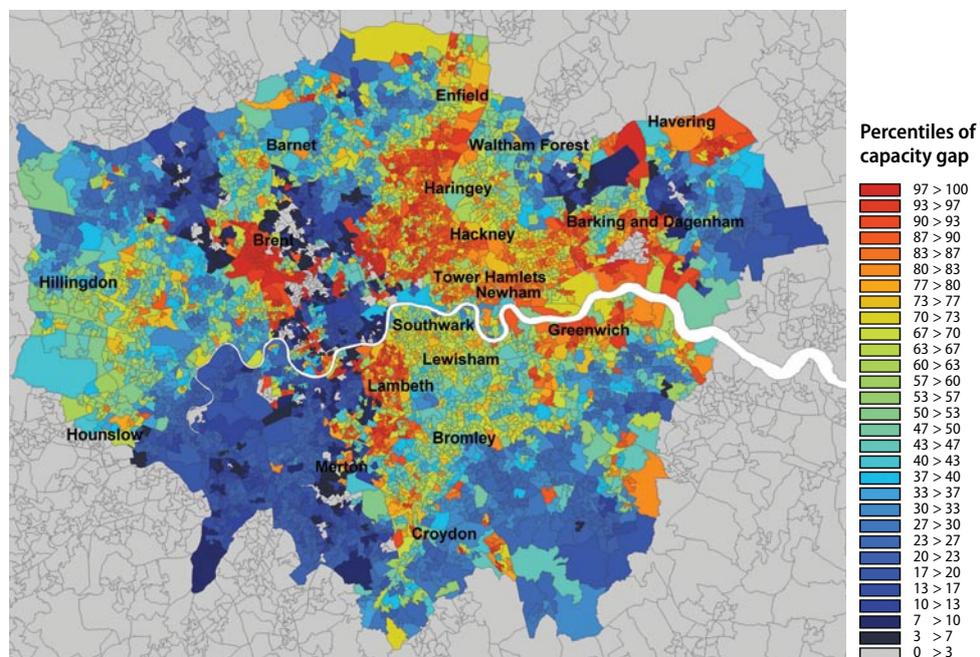
Credit unions in London have achieved significant growth in membership and made important advances in capacity, management and governance in recent years, as will be described in following chapters. Credit unions are now available to all who live or work in 27 out of 33 London boroughs. There remain however important areas of unmet need in which there is little or no community finance supply. Essentially credit unions are strongest in the South East, notably Southwark and Lambeth, and in some parts of the East End, notably Tower Hamlets. Nonetheless there remain significant gaps in effective coverage in deprived areas both North of the river and in parts of East London, with weak coverage also to the West.

Areas of capacity gap include some of those locations where financial and credit exclusion and deprivation is most concentrated. The map following in figure 13 indicates the areas where the capacity gap between affordable credit supply¹⁰ and need, as defined by the index of multiple deprivation and credit exclusion, is greatest.

Figure 13

The capacity gap is greatest in North, West and East London where there is greatest need and where social lenders have been less active

Percentiles of capacity gap index (components: deprivation and growth fund lending)



Credit Union and social finance lending in London remains much smaller than private sector high-cost lending

1.11 The Growth Fund experience

Credit Union and social finance lending in London remains much smaller than private sector high-cost lending. The experience of the DWP Growth Fund, presents, however, encouraging evidence of the potential of social lending and community finance to compete with private sector lending and high-cost credit. The scheme which operated from September 2006 to March 2011, delivered affordable credit in the form of over 44,000 subsidised loans to low-income London borrowers.

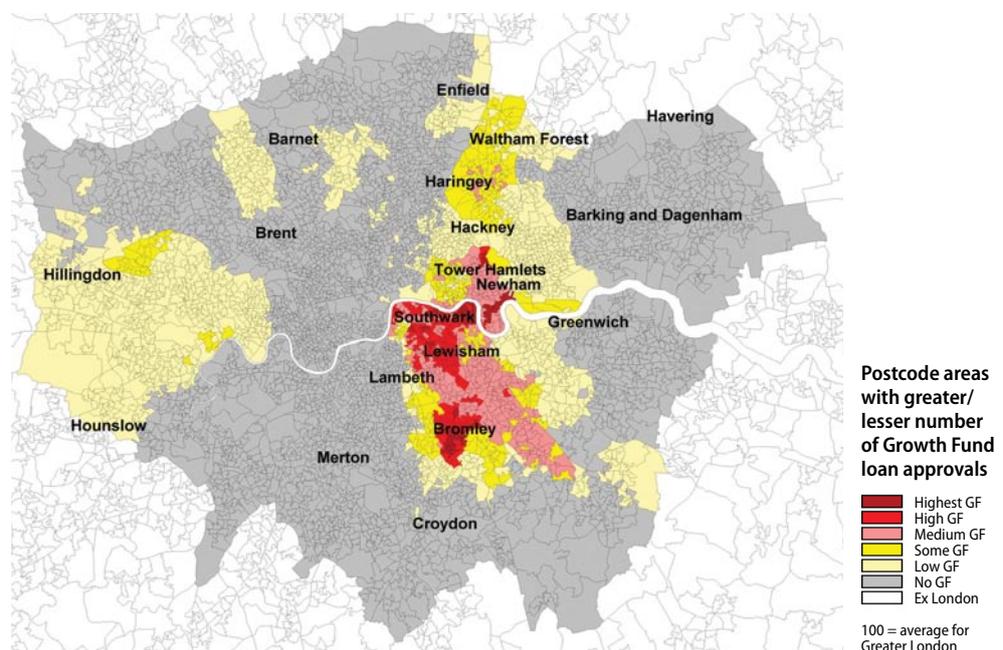
¹⁰ Composite index formed by the subtraction of the composite score in the index of multiple deprivation from the number of growth fund loans.

The DWP Growth Fund, as its name suggests, was intended to act as a catalyst for the growth and development of the community finance sector and was focused on those credit unions and CDFIs with the capacity both to reach out to very low-income borrowers and the potential for growth as social businesses. Given these criteria, subsidised Growth Fund loans made to low-income borrowers over the period of the scheme's tenure unsurprisingly cluster around those areas where credit unions have historically been strongest, notably in the South and East. Growth Fund reach in West London is much lower with lending North of the river heavily concentrated in Tower Hamlets with little coverage in some areas of significant deprivation.

It is striking that there is comparatively little cross-over between Growth Fund loan approvals and the areas where home credit is strongest. However, it is equally striking that Growth Fund loans appear to have reached some disadvantaged communities which home credit is not serving, notably deprived high rise estates.

Figure 14
Growth Fund loans heavily concentrated in Southwark and Lambeth in the South and in Tower Hamlets North of the river
 Concentrations of Growth Fund loan approvals – Greater London

Growth Fund loans appear to have reached some disadvantaged communities which home credit is not serving

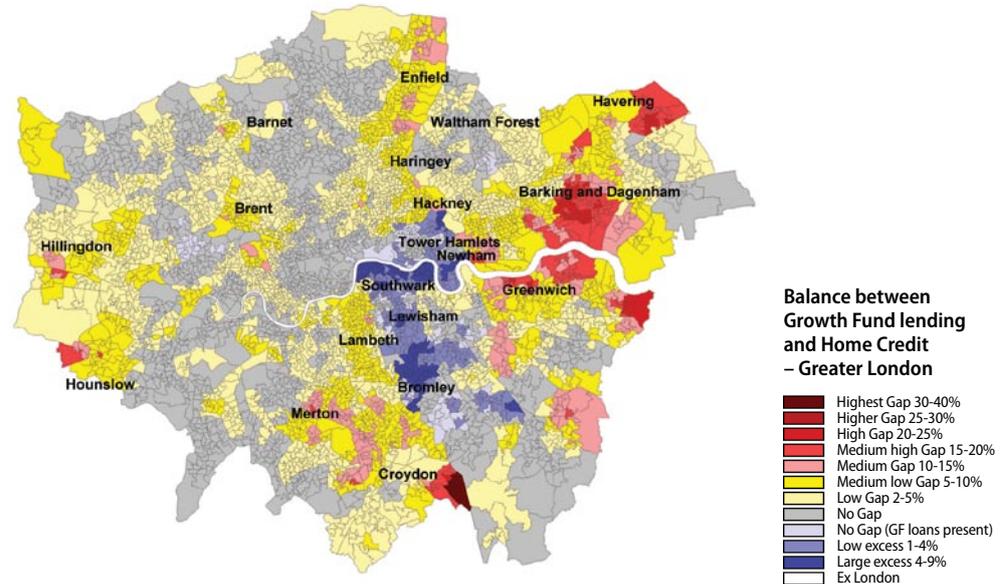


Importantly, in the Growth Fund heartlands in the South, also those areas of greatest credit union strength, Growth Fund loans appear to be more important than home credit as a source of credit for those on low incomes. This perhaps indicates some degree of competitive and displacement effect as well as the ability of social lenders to reach areas which home credit lenders have been less effective in penetrating. The map which follows shows the balance between use of home credit and Growth Fund loan approvals. In the areas where Growth Fund has been strongest, there is a small balance in favour of Growth Fund lending while in the outlying areas in which credit unions have less presence, home credit is clearly significantly more important.

Figure 15

In areas where Growth Fund has been strongest there is some evidence of a displacement effect in relation to home credit

Social Lending capacity gap/reach: Balance of % using HC loans and % using GF loans



In the outlying suburbs home credit remains unchallenged as an important source of credit for low-income communities

Nonetheless there remain large areas of London to the North and East and in outlying suburbs which the Growth Fund did not reach on any scale. In the outlying suburbs particularly home credit remains unchallenged as an important source of credit for low-income communities, with the quantitative data suggesting that illegal money lending continues to be a feature of these communities also. New high-cost lenders are also increasingly entering the London market offering high-cost credit both through the opening of retail stores and over the internet, albeit that these operators also appear to focus in the less deprived areas where the population is more stable.

1.12 Overall

The analysis of the demand environment described in this chapter demonstrates clearly the need for affordable credit in the capital. It also suggests that, relative to the national picture, Londoners are more likely to be credit excluded, with lower levels of use of mainstream credit products and less access even to high-cost credit than low-income communities elsewhere and in other urban conurbations. Londoners are also less likely to have access to social lending and thus also more reliant on informal borrowing and more exposed to the risks of illegal money lending. The evidence suggests that these problems are most acute in the inner city and in minority ethnic communities, albeit that the evidence also shows unmet demand for credit is greatest among low-income white Londoners, who are the most likely users of sub-prime and high-cost credit.

Analysis of the fit between demand and social lending supply highlights that there are important social lending capacity gaps in that there are areas of London, notably in the North, East, and West of London, where there is little or no social lending coverage. These areas include some of those concentrations of greatest need and most intense deprivation.

This situation poses both challenges and opportunities for social lenders and the effort to scale community finance in London. It also underlines the importance of the task and the need to modernise and extend the social lending sector to meet a very real need.

2.1 Origins, development and modernisation

The first credit unions in Britain were established by immigrants in London who, once settled in this country, found it difficult, if not impossible, to obtain credit from banks and mainstream financial providers. Hornsey Community Credit Union in North London, for example, one of the first credit unions, was formed by Jamaican members of a Baptist church and registered in 1964 to serve the needs of the Caribbean community. Immigrants at the time were often disadvantaged by loan companies charging them particularly excessive interest rates (O'Connell 2005). In the same period, Caribbean and Irish immigrants also registered Wimbledon Credit Union, reputedly Britain's first credit union, with a common bond based on the geographical boundary of a Catholic parish.

By 1979, credit unions were to be found throughout London operating in Highgate, Camberwell, Clapham and District, Highbury (Acme Co-operative Credit Union), North Paddington, Pimlico, Croydon, Forest Gate, Shepherds Bush, Harlesden (Shrine Credit Union), Notting Hill (St Mary's Credit Union), Tower Hamlets, Herne Hill (South London Community Credit Union) and Waltham Forest. There was also a London-wide associational credit union, Alpha Metropolitan, established to serve the staff of the diplomatic community, but which mainly served those in the Jamaica High Commission. Of the 45 credit unions that formed the Credit Union League of Great Britain (later ABCUL) in 1979, 17 (38%) were in London.

Local, self-help organisations established and run by volunteers

These early credit unions in London, as elsewhere in Britain, were small, local, self-help savings and loans organisations established and run by volunteers with a strong sense of social purpose. This was primarily to provide low cost loans to savers on low incomes who had little or no access to other financial institutions. Some credit unions, such as Hornsey, recruited over 200 members, but many had significantly less. Most were run from church or community halls, or even from members' own homes, and high priority was given to community involvement, member participation and the personal development of volunteers.

By the early 1970s, credit unions had already attracted the attention of Government, and in recognising the difficulties people without bank accounts faced in accessing credit, the Crowther Committee on Consumer Credit (1971) argued a prima facie case for supporting the development of credit unions. Appropriate legislation and regulation was recognised as key to credit union development, which led to the passing of The Credit Unions Act in 1979.

Following the Act, there was new interest in credit unions in London and in their potential to offer not only local communities, but also associations and groups of employees, access to savings and loans products appropriate to their needs within a member-owned financial co-operative. London cabbies were one group that often found it hard to borrow from banks and in 1979 the Licensed Taxi Drivers Association Credit Union was the second credit union to be registered under the new Act. Pentecostal Credit Union was founded a year later in Balham and, through the national Pentecostal Church, counted many Caribbean Londoners in the membership. In 1982, Southwark Council Employees Credit Union was created by volunteers to serve council workers, many of whom were on low wages and faced difficulties in accessing affordable financial services (Decker and Jones 2007). In fact, Southwark was the first employee credit union to offer employees the benefit of direct payments through payroll deduction, a facility that would become central to credit union growth throughout the country. Through the 1980s and 1990s, the social and economic deprivation faced by many low-income communities in London encouraged the continued development of community-based credit unions. These were often supported by local authorities as a strategic response combating poverty. Political support for credit unions grew and they became increasingly

Early credit unions in London, as elsewhere in Britain, were small, local, self-help savings and loans organisations established and run by volunteers with a strong sense of social purpose

seen by central and local government as vehicles for regenerating local economies and as one solution to the credit needs of the poor (Thomas and Balloch 1994, Donnelly 2004). It was through this period that the Greater London Council (GLC) funded ABCUL's regional organiser¹¹, a development worker, and five credit union development programmes which placed managers in Shrine, Camberwell, Pimlico, Pentecostal and LTDA Credit Unions.

By the end of the 1990s, however, it had become clear that credit unions in London, as elsewhere in Britain, were not developing at a rate seen in other parts of the world. Most community credit unions serving low-income communities remained financially weak, vulnerable and serving less than 200 members (Jones 1999, Goth et al 2006). The development of those serving employee groups was stronger but still relatively modest.

A new vision of effective credit union development

It was this level of overall lower-than-expected performance that led credit unions, from the end of the 1990s onwards, to rethink and reform their purpose, their business model and their systems and operations (Jones 1999). Credit unions started to adopt a business-oriented approach to development based on robust business planning, operating from suitable high-street, premises, introducing IT, and on the employment of professional staff. Credit unions realised that if they were to become stable and effective financial institutions, they would first have to acknowledge economic realities and adopt a more commercial approach to the business.

A new vision of effective development, it saw credit unions, as co-operative financial institutions, serving the financial needs of a more economically diverse population, within which a focus on low-income and disadvantaged groups could be preserved

This changing approach resulted in the emergence of a new vision of effective development (Jones 2005). It saw credit unions, as co-operative financial institutions, serving the financial needs of a more economically diverse population, within which a focus on low-income and disadvantaged groups could be preserved. It prioritised the maximisation of savings, not just to create funds to on-lend, but to enable people to build personal assets and to achieve financial stability over the longer term. This new vision challenged credit unions to rethink their product offering, at the time often limited to a simple loan account linked to the value of borrower's savings balance. The challenge was to diversify and to offer a range of modernised financial products and services that met the varying needs of different segments of the low and moderate-income market. Integral to the vision was organisational soundness and stability and an emphasis on operating efficiency, financial discipline, good governance and effective management.

Importantly, this vision aimed at ensuring that economically disadvantaged members would have access to financial products and services, the quality of which compared with or exceeded those found in conventional financial institutions (Richardson 2000a). The aim was to offer a pathway to long term financial stability to people in low-income communities, within a co-operative financial institution which they co-owned and which was free of any stigmatisation arising from being regarded as a 'poor-person's bank'.

This vision was captured within the concept of a 'quality credit union' (ABCUL 2005, Jones 2006). This stressed the importance of a strong board of directors and of skilled managers with the leadership skills and competence to drive credit unions forward; of market research to ensure products and services met members' needs; of an approach to credit granting based on flexibility, responsibility and rigorous assessment of repayment capacity; and of a recognition that long-term sustainable development is built on generating member savings and not on continued dependence on external capital or grant subsidies.

This vision of quality in credit union governance, management and operations was supported by a number of improvements to the existing credit union legislation and regulation. It can be argued that the Financial Services and Markets Act 2000 (FSMA 2000), the legislative changes of which for credit unions came into force on 2 July 2002, was, after the 1979 Act, the single most important legislative advance for the British credit union movement. It offered credit unions greater opportunity to compete within financial markets, and brought them under the regulatory framework of the Financial Services Authority. It was this latter development that introduced

¹¹ ABCUL's regional organiser in London throughout the period was Peter Bussy, who retired from ABCUL in May 2011.

a culture of compliance in which all credit unions had to meet defined threshold conditions and operating standards. Importantly, it established the Financial Services Compensation Scheme (FSCS), which provided financial protection for credit union members' savings.

Serving a wider segment of low and moderate income people

In research interviews with managers in the 15 London credit unions participating in this study, it was apparent that they all shared the vision of credit unions serving a wider segment of low and moderate income people, and of their continuing to take a greater professional and commercial approach to the business. Notwithstanding the challenges and difficulties faced by individual credit unions, all considered that the changed business-oriented approach to credit union development had impacted positively on credit unions in the capital; and they were able to point to significant developments within their own credit unions and within London credit unions as a whole over the last ten years.

In fact, the research study identified 35 credit unions currently operating within the Greater London boundary (see Appendix One):

- Five serve employee or self-employed groups solely within London
- Four serve a national employee membership but with a substantial membership in the capital
- Three serve an associational membership in London
- Two serve a national associational membership but with a substantial membership in the capital
- 21 have open residential or live-or-work common bonds, able to serve everyone in their geographical area of operation

Since 2005, credit union growth in London is encouraging and significantly higher than the national average

Of the 21 open residential or live-or-work common credit unions, in 2009, 15 had over 500 members, 10 had over 1,000 members, three had over 5,000 members and one had over 10,000 members. Six credit unions remained very small with less than 500 members.

The 15 credit unions invited to actively participate in research interviews were chosen, not just because they had an open live-or-work common bond, but that they represented credit unions with perhaps the greatest growth potential. Eight of these credit unions had over 1000 members. The group included the three largest live-or-work credit unions with over 5,000 members in 2009. This increased to four credit unions in 2010.

Credit union membership is growing in London

Credit union membership is growing in London, particularly since 2005. However, to date, overall credit union membership penetration in London still remains relatively modest compared with other large conurbations in the country. Membership represents about 1% of the total Greater London population; considerably lower than the 3% on Merseyside and the 5% plus in Glasgow.

The reasons for slower credit union growth in London are complex. Certainly, many of the early credit unions, established before the 1979 Credit Unions Act, according to a traditional model of development, failed to grow in any significant manner, and it is only since the turn of the century that London credit unions have begun to take a significant upward turn. A number of factors have fuelled this move to greater growth, including the change in common bond of a number of employee credit unions to be able to serve the wider community and the establishment of a number of new credit unions established with an agenda for growth and expansion. London Mutual Credit Union, now with over 10,000 members, started as Southwark Council Employees Credit Union and only opened its doors to the community in 1999. NewCred Community Credit Union, with now near 5,100 members, was only established in 2003 and London Community Credit Union, as Tower Hamlets Community Credit Union, with over 7,000 members, only opened in 2000. As shall be argued later, the other key factor stimulating growth in the sector has been the delivery of the Financial Inclusion Growth Fund.

Certainly, since 2005, credit union growth in London is encouraging and significantly higher than the national average¹². Credit unions in London now have at least¹³:

- £55m in assets (2009) – up 92% since 2005 (national increase 44%)
- £37m in loans (2009) – up 70% since 2005 (national increase 36%)
- £45m in savings (2009) – up 79% since 2005 (national increase 39%)
- Circa 60,000 members in London credit unions (2009) – up over 90% since 2005 (national increase 33%) (London credit union membership has grown on average by 18% per annum since 2004 – 2009, and by 20% in the year 2008/2009. This compares with a national annual average increase in the same period of around 8% and an increase in the year 2008/9 of 7.5%)

The credit union managers interviewed shared a common commitment to growth and to the expansion of access to affordable credit and other financial services in the capital. Most reported that their credit unions aimed to establish themselves as financial institutions with the capacity to serve an economically diverse membership, with the kinds of appropriate and affordable products and services such a membership requires.

Different approaches to organisational management and service delivery

However, it was clear that individual credit unions took different approaches to organisational management and service delivery and often faced distinct challenges, difficulties and resource issues. In all cases, the approach taken was autonomous and challenges were mostly faced independently of other credit unions. It was the diversity of response to the challenge of change that was most clearly apparent in interviews. Credit unions in London vary not only in size, but also in strategic decision making and, undoubtedly, also in leadership drive, management skill and operational capacity to develop the business.

There are, however, leaders in the field, which are professionally-managed and well governed credit unions that are open, accessible and visible in the marketplace and that are able to offer quality financial services to an increasing number of members. They often offer a range of savings and loan accounts, insurance and other financial services, and, in three cases, offer a transactional current account, the Credit Union Current Account. These credit unions often have strong partner relations with local authorities, social housing providers and other agencies. Some are former employee-based credit unions which have opened their membership to the community at large. In this group are some of the most financially stable credit unions in the capital, two of which are considering applying to become Version 2 credit unions¹⁴. These would be the first open, live-or-work credit unions in London with Version 2 registration.

There are also a number of credit unions opened with the financial support of regeneration programmes and/or local authorities. These credit unions have visible high-street premises and paid staff and endeavour to offer a range of financial services to people on low incomes. Several have been in operation only for a few years and have not yet built the business sufficiently to become independent of external financial support. Even though these credit unions currently mostly serve members on low incomes, they are endeavouring to reach a more economically diverse membership base with varying success.

There are other credit unions that retain many of the traditional features of local, self-help community organisations and are built on a strong sense of local identity and commitment

The credit union managers interviewed shared a common commitment to growth and to the expansion of access to affordable credit and other financial services in the capital

¹² National credit union statistics on which the percentage calculations are based on those supplied by ABCUL based on FSA returns. Credit union membership in Britain grew from 529k in 2005 to 705k in 2009; assets were up from £466m to £673m in the same period, loans up from 337k to 460k, and savings up from £410m to £569m.

¹³ These figures for assets, loans and savings are based on statistics provided by 21 credit unions only. They also include the figures for Plane Saver Credit Union, based at Heathrow, whose London membership was difficult to estimate but is considerable. No other credit union with a national membership has been included. The overestimation based on Plane Saver figures is compensated for by the lack of inclusion of the figures for 10 missing eligible credit unions. The calculation of membership is based on statistics from 30 credit unions and thus, is an underestimation of membership in London.

¹⁴ Credit unions can either register with the FSA as Version 1 or Version 2 credit unions. Version 2 credit unions are subject to more stringent capital, liquidity and supervisory requirements, but can offer a wider range of loans and savings products to members.

to the community. For the most part they offer a more limited range of products and services to a smaller membership base, even though there are examples of these more traditional model credit unions notably increasing their membership. There is often a high involvement of volunteers in running the business. Some of the smaller credit unions, however, that have found it difficult to manage their own operations have, to reduce costs and dependency on operational volunteers, contracted out administrative and operational management to an independent company based in West London. These credit unions now operate mostly on the phone or from the company's office rather from their own independent premises.

There are some credit unions that have remained very small, with at most a few hundred members. It is apparent that some of the very small credit unions do not necessarily share a vision to develop as financial co-operative institutions with the capacity and the resources to serve significant sections of the low and moderate income market. Some will have the stability to continue as small grass-roots co-operative enterprises with a defined and limited membership base; others may seek to transfer to other credit unions over time.

The impact of the Government's Financial Inclusion Growth Fund

The credit unions that have grown most significantly in London are those that have delivered the Government's Financial Inclusion Growth Fund (see Figure 16). This Government programme, administered by the Department of Work and Pensions (DWP), aims to assist credit unions and CDFIs¹⁵ to expand access to affordable credit in low-income communities and to enable financially excluded borrowers to migrate from sub-prime loan companies into credit union or CDFI membership.

Eleven London credit unions participated in the Growth Fund, eight of which continued to do so up until the termination of the programme in March 2011. The programme was delivered in two tranches. A small number of credit unions did not want to proceed to the second round and exited from the Growth Fund mainly because of administrative challenges involved in delivering the first round of the programme.

Since the start of the Financial Inclusion Fund in September 2006 and up to March 2011, credit union contractors in London have:

- Granted over 44,000 loans to low-income borrowers, 78% of whom are women and over 80% social housing tenants (see Table 1)
- Made loans to total value of over £19 million
- Opened over 25,000 current or savings accounts for Growth Fund borrowers
- Maintained less than 10% DWP target delinquency rate¹⁶ on loans in 87% of the participating credit unions

Growth Fund contracts were awarded by the DWP to credit unions that were assessed to possess the managerial and organisational capacity to deliver affordable credit to large numbers of low-income people, but undoubtedly the experience of delivering the Growth Fund has itself assisted the majority of participating credit unions to develop their own systems and procedures, and improve organisational performance as they strove to meet DWP targets and reporting requirements. The majority of managers interviewed regarded their credit union's participation in the Growth Fund as positive and as perhaps the single overriding factor stimulating credit union growth. This replicates the findings of research carried out in 2008, in which London credit unions participated, which revealed that 76% of all credit unions that were delivering the Growth Fund considered it had assisted their credit union to grow (Jones 2008).

¹⁵ CDFI – Community Development Finance Institution

¹⁶ Delinquency refers to loan repayments that are overdue or unpaid

The credit unions that have grown most significantly in London are those that have delivered the Government's Financial Inclusion Growth

Table 1
Financial Inclusion Growth Fund delivery by credit unions in London

	2006	2007	2008	2009	2010 – March 2011
Credit unions	9	11	10	8	8
Number of loans					
Loan applications	2834	8558	8670	12054	13984
Loans made	2690	8198	8282	11584	13542
Value of loans					
Value of loans made	£1,136,038	£3,543,694	£3,066,898	£4,925,342	£6,421,990
Average loan value	£422.31	£432.26	£370.30	£425.18	£474.22
Other financial services					
Customers with Bank or savings accounts opened	532	1508	5934	7835	9478
Customer profile					
Percentage women	76%	74%	79%	77%	88%
Lone parent	59%	53%	59%	58%	65%
Percentage White British	50%	45%	43%	42%	47%
Percentage Black British	28%	31%	30%	27%	34%
Social housing tenants	84%	83%	81%	80%	88%
High interest loan history	22%	23%	23%	21%	23%
Unemployed	80%	77%	75%	79%	90%
Incapacity benefit	11%	11%	11%	11%	14%
Age profile					
18-24	20%	17%	10%	11%	11%
25-34	35%	33%	35%	34%	34%
35-49	34%	37%	39%	38%	38%
50 – 64	9%	11%	13%	14%	14%
65+	2%	2%	4%	3%	4%

Some London Growth Fund credit unions have changed out of all recognition. In five years, 2005 – 2010, Lewisham Plus Credit Union has grown from 1,385 to 5,001 adult members (a 261% growth).

Some London Growth Fund credit unions have changed out of all recognition. In five years, 2005 – 2010, Lewisham Plus Credit Union has grown from 1,385 to 5,001 adult members (a 261% growth). It now offers a comprehensive range of products and services, including transaction banking with the Credit Union Current Account. It has excellent partnership relations with social housing providers, and has expanded operations to serve two London boroughs, opening a new branch in Bromley. Similarly, in the same period, London Mutual Credit Union has grown from 4,454 to 11,500 members (160% growth), expanded operations into nearby Lambeth and has opened a new high-profile and very visible branch office in the heart of Brixton.

As Table 2 illustrates, most Growth Fund credit unions have exceeded the average London membership growth rate of 90% for the period 2005 – 2009 (2010 figures were not available for all credit unions to bring this ratio up to date). Clearly some credit unions have increased membership more than others, and indeed some Growth Fund credit unions have grown less than the average. However, overall, membership growth in Growth Fund credit unions has been significantly increased.

Table 2
Financial Inclusion Growth Fund Credit Unions in London

Growth Fund Credit Union	Boroughs	Growth Fund phase	Membership growth 2005–2009
1. Ealing Credit Union	Brent and Ealing	1,2	60%
2. Hammersmith & Fulham Credit Union	Hammersmith	2	n/a
3. Lewisham Plus Credit Union	Lewisham, Bromley	1,2	206%
4. Liberty Credit Union	Havering, Barking & Dagenham	1	98%
5. London Mutual Credit Union	Southwark, Lambeth	1,2	139%
6. M for Money Credit Union	Hillingdon, Harrow	1,2	63%
7. Newcred Community Credit Union	Newham	1	113%
8. North London Credit Union	Haringey, Enfield, Barnet	1,2	52%
9. Thamesbank Credit Union	Hounslow	1,2	n/a
10. London Community Credit Union	Tower Hamlets, Hackney	1,2	139%
11. Waltham Forest Community Credit Union	Waltham Forest	1,2	186%

It is significant that Growth Fund credit unions have also outperformed other credit unions on the retention of savings

As Figure 16 illustrates, credit union performance in relation to both the development of the loan portfolio and the maximisation of savings has also exceeded the London credit union average for all groups. It is nearly double that of non-Growth fund live-or-work credit unions. It is to be expected perhaps that Growth Fund credit unions would display higher loan growth rates, given the increased capital for on-lending, but it is significant that Growth Fund credit unions have also outperformed other credit unions on the retention of savings. This can be noted as an important outcome of the Growth Fund investment over and above increasing access to affordable credit.

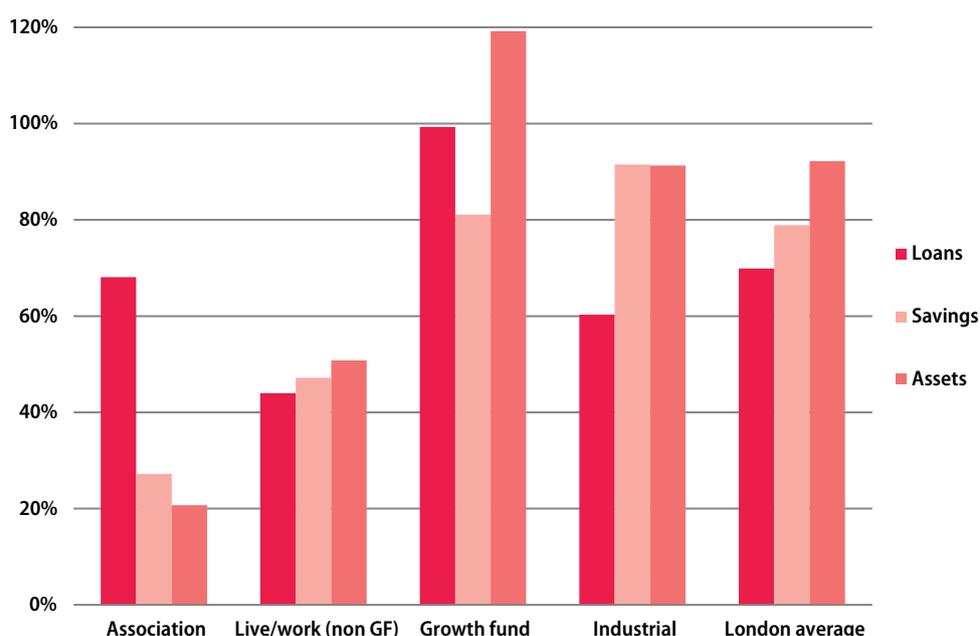
It is clear that most of the credit unions in London delivering the Growth Fund have demonstrated a capacity to reach out to those on the lowest incomes and to enable them to access affordable credit and other financial services successfully. It is important to add, however, that there are some other non-Growth Fund credit unions that have also performed well over the period from 2005, sometimes with the support of external capital from a local authority. Islington Credit Union¹⁷, for example, has grown its membership by 327% in the period 2005 – 2009, and, in the same period, Croydon Credit Union¹⁸ grew by 170%.

In interviews, some concern was expressed by Growth Fund credit unions about the long-term ‘quality’ of many of the new financially excluded members recruited in recent years with the support of the Growth Fund and of the sustainability of serving hard-to-reach, high risk groups if all external funding (Growth Fund and local authority) ends in March 2011. The challenges faced by credit unions in serving higher risk, financially excluded groups is discussed in a later section of this report (see Section 2.3).

¹⁷ Now Haringey, Islington and City Credit Union Ltd.

¹⁸ Now Croydon, Sutton and Merton Credit Union Ltd.

Figure 16
Credit union growth in London since 2005 – loans, savings and assets



Financial and organisational challenges have led a number of credit unions to transfer engagements to, or merge with, larger credit unions in order to achieve stability, to enable investment and to ensure the extension of access to credit union services

Economic and organisational challenges

Not all credit unions are developing successfully. There are undoubtedly some organisationally weak and vulnerable credit unions that are liable to closure or to having to transfer to another strong credit union. During the research study, three London credit unions ran into serious difficulties. Hackney Credit Union, a high profile institution launched in November 2005 with significant support and financial backing, was declared in default by the Financial Services Compensation Scheme in June 2010 due to rising bad debts, poor management and the ending of external subsidies from the local authority. Also in 2010, Deptford and New Cross Credit Union and Harp Credit Union had their regulatory permissions to continue the business withdrawn by the Financial Services Authority. However, Deptford and New Cross Credit Union had its deposit taking permission reinstated with agreement of the FSA to transfer engagements to Lewisham Plus Credit Union. This transfer of engagements was completed in January 2011. Since 2002, nine London credit unions have been declared in default by the Financial Services Compensation Scheme and have closed, having had to make claim on the FSCS funds¹⁹.

Financial and organisational challenges have led a number of credit unions to transfer engagements to, or merge with, larger credit unions in order to achieve stability, to enable investment and to ensure the extension of access to credit union services. In March 2010, for example, Lambeth Savings and Credit Union transferred into London Mutual Credit Union, and North West London Credit Union is a combination of Barnet Credit Union, Finchley Credit Union and Watling and Grahame Park Credit Union. As previously noted, Deptford and New Cross Credit Union has transferred engagements into Lewisham Plus Credit Union.

It was generally accepted in research interviews with managers that further transfers of engagements or closures of credit unions would be more rather than less likely given the economic realities of building the credit union business, especially in the context of declining external financial support. Even some managers in larger credit unions said they could envisage the day when their own credit union would need to merge with other credit unions in order to promote efficiency and stability within the London credit union movement.

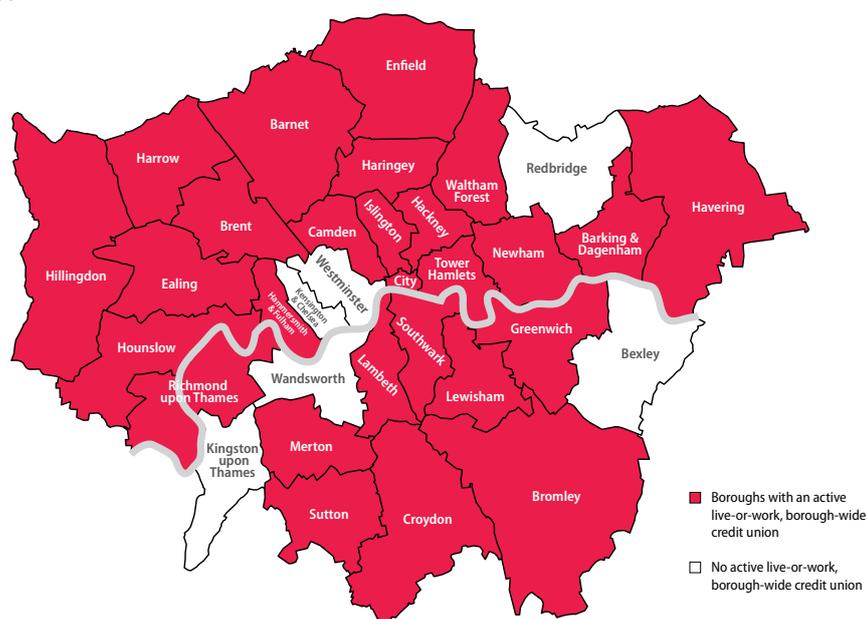
¹⁹The nine credit unions declared in default since 2002 are Thameswood Credit Union Limited, in 2002; Cathall Community Credit Union Limited, Shepherds Bush Social and Welfare Credit Union Limited; and Croydon Branch Union of Communication Workers Credit Union Limited in 2003; Dalston Social and Business Credit Union Limited; Raffles Area Credit Union Limited, and Hackney South Credit Union Limited in 2004; Edmonton Credit Union Limited in 2008 and Hackney Credit Union Limited in 2010. In addition, in 2010, Deptford and New Cross Credit Union and Harp Credit Union have had permissions withdrawn by the FSA to engage in regulatory activity, but action has not yet proceeded to the Financial Services Compensation Scheme.

Impact of the live-or-work common bond

The need for weaker credit unions to transfer engagements into stronger ones was one of the factors that stimulated a process of credit unions beginning to expand operations throughout the borough within which they already operated. Before 1996, it was not possible for a credit union to serve all the people who lived and worked in an area the size of a London borough. Credit unions were either employee based, associational or residential serving the residents of a relatively small defined locality. However, through the Conservative Government's Deregulation (Credit Unions) Order 1996, the regulator introduced the live-or-work common bond, and, at the same time, began to accept the registration of common bond based on a "locality" defined as "comparable in extent to a principal tier of local government (for example: a single city, London borough or county)"²⁰.

Figure 17
London boroughs with a live-or-work, borough-wide credit union
 (See Appendix II)

*There are now
 16 borough-wide
 credit unions, open to
 everyone who lives or
 works in 27 out of the
 33 London boroughs*



It was this change, for example, that enabled the then Southwark and Kings Employees Credit Union (now London Mutual Credit Union) to be the first employee credit union in London to open its common bond in 1999 to the whole of the local authority borough. One of the drivers for this was to facilitate the transfer in of the then struggling Borough and Bermondsey Credit Union into the new Southwark Credit Union, which happened just months after the regulatory permission to expand was granted.

By 2000, there were two credit unions with a borough-wide common bond. However, over the last ten years, and particularly within the last few years, there has been an increasing registration of borough-wide common bonds. In most of these cases, it has not been in order to rescue weak credit unions, but rather to expand access to affordable credit union and other financial services within a greater borough locality. There are now 16 borough-wide credit unions²¹, open to everyone who lives or works in 27 out of the 33 London boroughs, serving some five million Londoners. 29 London boroughs now have some level of credit union activity (see Appendix II).²²

²⁰ CRED 13 Annex 1A Common bond

²¹ The 16 borough-wide credit unions are: 1. Camden; 2. Croydon, Merton and Sutton*; 3. Ealing*; 4. Greenwich; 5. Hammersmith and Fulham; 6. Haringey, Islington and City*; 7. Hillingdon; 8. Lewisham Plus*; 9. Liberty*; 10. London Community*; 11. London Mutual*; 12. M for Money*; 13. NewCred Community; 14 North London; 15 North West London; 16, Thamesbank*. Wandsworth Credit Union is also technically able to serve the entire borough of Wandsworth but is not included in this list as it has less than 50 members. The nine asterisked credit unions serve more than one London borough.

²² Stop press! As this report was going into production in June 2011, it was announced that Shrine Community Credit Union Ltd has had its common bond extended to the whole of Brent. Ealing Credit Union also serves the whole of the same borough. This makes 17 borough-wide credit unions in London.

Clearly there are still boroughs that are not served by credit unions, and indeed it is true that even where a borough-wide credit union exists, membership penetration in the greater locality can still remain low. Current moves to expand credit union services into new boroughs is tending to be achieved, not by the expansion of smaller credit unions within those boroughs, or by the creation of new credit unions, but rather by expansion of credit unions already serving other neighbouring boroughs. The creation of a credit union to serve an unserved borough can be one option, but, as is explored later in Section 2.8, can be a greater challenge than that which arises from an existing credit union expanding its area of operation.

The expansion of credit unions to serve two rather than one borough has been, however, a recent development, and, as with the original borough-wide expansion, was prompted in one case by the need to receive the engagements of a weaker credit union. The first two-borough credit union was Lewisham Plus Credit Union in December 2009 when it was granted a common bond to include the whole of the borough of Bromley. This was quickly followed by London Mutual, in March 2010, when it moved to merge with the struggling Lambeth Savings and Credit Union and serve the borough of Lambeth. Again in 2010, Tower Hamlets Community Credit Union²³ also expanded into Hackney, and even though Hackney Credit Union had closed, the credit union was able to pick up on serving Hackney's former members among others.

However, not all expansions are associated with supporting weaker credit unions. In 2010, Ealing Credit Union began to serve all who live or work in Brent, Liberty Credit Union has expanded into Barking and Dagenham; Croydon Savers Credit Union²⁴ has expanded into Merton and Sutton, creating the first three-borough credit union in London and Islington and City Credit²⁵ Union has expanded into Haringey. Early considerations were also voiced by Hammersmith and Fulham Credit Union about expanding into Kensington and Chelsea and by London Mutual Credit Union into Wandsworth, but as yet these considerations have not materialised into action. Of course, credit union expansion brings its own challenges and difficulties; and these are explored in Section 2.8.

Over the last ten, and particularly over the last five years, credit unions in London have changed, developed and expanded

Over the last ten, and particularly over the last five years, credit unions in London have changed, developed and expanded. Through the delivery of the Financial Inclusion Growth Fund, and local government supported initiatives, and assisted by a greater professional and commercial approach to the business, they have increasingly been able to reach out into low-income communities and build the overall membership by around 18% per annum, which well exceeds the 12% per annum target membership growth set by the World Council of Credit Unions. This expansion of the sector has built the confidence of Government and of many in local government in the potential of the sector as a whole to expand access to affordable financial services in the capital.

However, many challenges and hurdles remain. As was often stated in interviews with managers of credit unions and partner organisations, despite this progress, credit unions are still not well known in London and suffer from a lack of a clearly understood identity. Partner interviewees too often reiterated the perception shared by many Londoners that “credit unions were for the poor and not for people like me”, a perception that undermines the capacity and potential of the credit union to expand effectively.

In addition, credit unions in London still face challenges in developing the necessary skills and competences of staff and board members, and in ensuring effective governance and management systems and procedures. In many credit unions, significant financial challenges still remain in ensuring the long-term sustainable development of the business (see Sections 2.3, 2.4). It is clear from interviews that if credit unions are to realise their potential to widen access to affordable credit and other associated financial services to many more Londoners, they will need to continue to rethink and reengineer the nature of the business in order to improve operational performance and service delivery.

²³ Now London Community Credit Union Ltd.

²⁴ Now Croydon, Merton and Sutton Credit Union Ltd.

²⁵ Now Haringey, Islington and City Credit Union Ltd.

2.2 The provision of affordable credit in context

Expanding access to affordable credit to people on low incomes was central to the strategic development of all the credit unions engaged in the study. All managers, not just those delivering the Growth Fund, considered that serving the low-income market is part of the mission of the credit union and an essential aspect of its business.

There was an appreciation that people even on very low incomes need to borrow for essential items, to make ends meet or to smooth out the ups and downs of the household budget. Credit union managers understood the challenge of operating in a market where people needed to borrow small amounts, to repay weekly, often in cash, and where people on low incomes had regularly to rob Peter to pay Paul to manage competing priorities.

Nevertheless, they maintained that with the right products and support, most low-income borrowers managed to control their finances and to repay loans successfully, albeit sometimes over an extended repayment period. Most managers delivering the Growth Fund, for example, were encouraged to see how the vast majority of their borrowers repaid according to plan, with default rates within acceptable DWP limits. For them, the low-income market had become a relatively stable part of the business. This is not to say that some credit unions were not struggling to control bad debts, but the majority had achieved repayment rates that exceeded the average for lenders in the low-income market.

For managers, the challenge of serving the low-income market concerned the time and resources required to administer low-value loans and to give the one-to-one, personal support that many borrowers sought. This support turned on ensuring that loans were affordable to borrowers and that they offered a pathway to financial stability and security.

This pathway could not be built, it was argued, on access to credit alone; but rather comprised access to a holistic package of products and services designed to respond to the range of members' financial needs. This included access to debt and to money advice, to financial education, to savings and transaction accounts, and to insurance, as well as to affordable credit.

Assessing affordability

Ensuring a pathway to financial stability demanded first that credit was affordable to the borrower. Affordability was not seen as a function of the interest rate alone, but rather in reference to the impact of credit repayments, including interest, on the overall household budget. Credit was not affordable if it was judged to have a negative impact on the borrower's ability to pay for the necessities of life, to meet existing financial commitments and to make ends meet. It was affordable if it could be managed within the household budget, irrespective of income level.

Over the last decade, some credit unions in London, including all those delivering the Growth Fund, have moved away from making loans solely on the basis of a prior savings record and have introduced more rigorous income and expenditure assessments of capacity to repay. This has enabled these credit unions to waive the requirement for all borrowers to save for several months prior to making a loan application, and offer members instant access to credit, essential when serving the needs of low-income members (Jones 2001, 2005).

More rigorous credit assessment, however, has resulted in credit unions not being able to serve all loan applicants with credit. As any social or commercial lender, credit unions can only lend to those with the capacity to repay and not all people who want, or consider they need credit, are best served with a loan. A loan is not always the answer to a person's immediate financial situation. Around 18% of Growth Fund loan applications were refused by London credit unions on the grounds that it was unaffordable to applicants.

Some non-Growth Fund credit unions take an even more rigorous approach. At Haringey, Islington and City Credit Union around 50% of applications for instant loans are refused on the grounds that it would be irresponsible to lend to people who would struggle to repay. The credit union tends to promote saver loans as a requirement for people on low incomes and who are assessed as struggling with their finances. These loans require borrowers to save in advance of the loan in order to assess capacity to repay and, if the loan is agreed, during

As any social or commercial lender, credit unions can only lend to those with the capacity to repay and not all people who want, or consider they need credit, are best served with a loan

the period of the loan repayment as well. The aim of the credit union is to promote a positive attitude to savings and regularity of payments.

There are concerns in some credit unions about an increasing demand for second and third loans from low-income employed people, who are unable to obtain credit on credit cards and from banks. This increases their overall indebtedness to the credit union and longer-term affordability of borrowings. It is reported that some members are now nearly maxed out on credit within the credit union, with little chance of totally clearing the loan balance. Credit unions are also reporting an increasing demand for consolidation loans to pay off unaffordable debts with other providers. This raises the issue as to how affordable the loans will be, even if transferred to the credit union.

Promoting self-help and responsibility

Credit refusal based on the lack of sufficient disposable income is a relatively straightforward process. However, undoubtedly credit unions also take into account the commitment of the applicant to accept the personal responsibility of repaying a credit union loan. This can be a more complex process, and may involve credit unions seeking documentary evidence of past loan repayments to other lenders, or taking into account the results of credit checks. As previous research has indicated (Kempson et al. 2008), it can be a major cultural and emotional step for a borrower used to the convenience of a doorstep-collected home credit, for example, to transition to managing the repayment of a credit union loan.

Accessing credit in a mutual, self-help co-operative financial institution can demand a high level of personal commitment and responsibility. Credit unions have found that this can be challenging for some people, given the complexities and vulnerabilities of their situation, and it can be a factor in limiting access to affordable credit within the target market. Significant support and hand-holding is often required to assist financially excluded individuals to transition into credit union membership. As research into the operation of the illegal lending teams found, for some people, even with support, transitioning into the stable credit union membership is problematic (Ellison et al. 2010).

In order to ease the transition into credit union membership, some credit unions, for example Camden and Hammersmith and Fulham Credit Unions, have developed such products such as the Child Benefit Loan, where repayments are automatically deducted from the members Child Benefit. There is therefore no onus on the member to 'remember' to make their weekly payment.

Access to money and debt advice

Support offered to people seeking access to affordable credit often entailed signposting people to money and debt advice services. The credit union movement nationally has promoted strong working relationships between credit unions and money advice agencies. In London, most but not all credit unions had some link with Citizens Advice Bureaux, independent advice agencies or local authority welfare rights services. Hillingdon Credit Union, for example, was an active participant in the CONNECT project, through which ABCUL linked up with Citizens Advice to support partnership working between credit unions and Citizens Advice Bureaux. All managers interviewed regarded access to money and debt advice as an essential element of a successful pathway to financial security for people seeking loans who were already in financial difficulties.

However, the strength of the link with money and debt advice agencies was variable. Some credit unions had strong working referral relationships with money and debt advice agencies, whilst others were limited to having information leaflets available. Some years previously, the complexities and challenges that credit unions and money advice agencies face in partnership working had been explored through a project linking London Mutual Credit Union and Blackfriars Advice Agency (Jones 2008).

Haringey, Islington and City Credit Union joined up with the Consumer Financial Education Body (CFEB)²⁶ to offer free, confidential money guidance sessions. Members were able to

All credit unions interviewed regarded the promotion of saving as central to enabling members to achieve financial stability

²⁶ Now the Money Advice Service

make an appointment with an impartial money advisor to discuss any questions or concerns they had about their finances and financial situation.

The promotion of a culture of saving

All credit unions interviewed regarded the promotion of saving as central to enabling members to achieve financial stability. Traditionally, in many credit unions, fighting poverty often was seen as primarily meaning widening access to credit so that people could free themselves from dependence on high-cost sub-prime lenders. This can be, however, as Burger and Zellmer (1995) point out, like putting the cart before the horse. Borrowing at affordable rather than high-cost interest rates certainly can help to balance the household budget in the short term but, by itself, it cannot lead to longer-term financial stability and independence. It leads only to further dependence on borrowing in the future.

On the other hand, building savings, or assets, can change the way people think about their own financial situation, and, as argued by Sherraden (1991), directly contributes to moving people out of poverty, both economically and psychologically. As Sherraden maintained, accumulating savings, or assets, can result in a range of positive effects which include planning for the future, health and well-being and increased participation in the community. Based on research carried out in the US, he maintained that even building small savings balances can result in such positive effects, a finding supported in Britain through research into Saving Gateway pilot programmes. Kempson et al (2005), for example, found that a high proportion of Saving Gateway participants reported feeling more in charge of their lives and more secure financially. This is a reality that was often evident to credit union managers among people who have never previously had the opportunity or the support to save.

Paying a dividend on savings, often not a priority in traditional borrower-focused credit unions is now seen by managers as critical to success

In London, most credit unions have developed a range of savings accounts designed to meet the specific needs of people on low incomes. These include standing savings accounts, save to borrow accounts, Christmas savings accounts, junior accounts and Sharia compliant accounts. These have often adopted deposit-side or withdrawal-side commitment mechanisms to assist individuals to make regular deposits. Examples include; default savings transfers from benefit accounts when a deposit is made, or an agreed savings element when repaying a loan. On withdrawal-side commitments, Lewisham Plus Credit Union offers a Christmas savings account, as do other London credit unions, which enables members to save flexibly each month. Members can start or stop saving at any time, but money cannot be withdrawn from the account until December.

Even though exact figures were not available at the time of this study, there was some evidence that default mechanisms had resulted in many Growth Fund members saving whilst repaying loans. Over the five year period 2006 – 2010, DWP calculated that over 21,000 current or savings accounts had been opened for Growth Fund borrowers. This seems to have supported savings growth in Growth Fund credit unions (see section 2.3).

Paying a dividend on savings, often not a priority in traditional borrower-focused credit unions is now seen by managers as critical to success. Most credit unions interviewed paid a dividend on savings around 1%, a rate which matches, or beats, interest currently paid on small savings in banks. However, given financial constraints, not all credit unions in London are able to pay a dividend on savings. This clearly is an issue for the future; if interest rates rise on savings in banks, having the capacity to pay a dividend will become essential to attracting savings into credit unions. Following legislative and regulatory changes in 2011, an increasing number of credit unions will be able to provide a range of savings products with varying interest rates, but they will need the capacity and financial strength to do so.

The importance of transaction banking

Access to transaction banking is often regarded as a gateway to financial inclusion, and widening access to a bank account formed a central part of previous Government policy. Not only is not having a bank account a barrier to employment or starting a business, it results in having to pay far higher charges for cashing cheques and for paying utility bills. Lack of a bank account is often also linked to wider social exclusion.

It was this link between transaction banking and financial inclusion that motivated ABCUL to partner with The Co-operative Bank to enable credit unions to offer a transactional banking service, fully under credit union control. Since 2006, credit unions are now able to offer a Credit Union Current Account, with Visa ATM and debit cards and functionality for direct debits, standing orders and money transfer. This was a major advance for British credit unions and had taken them one step closer to becoming full service financial institutions.

In London, the majority of credit union managers interviewed regarded access to a current account as an important element in offering members a pathway into financial inclusion. With the support of the Growth Fund, three credit unions now offer the Credit Union Current Account to their members, with the result that it is now available to the residents of six London boroughs; Bromley, Lambeth, Lewisham, Southwark, Hackney and Tower Hamlets.

The introduction of the current account was just a first step for credit unions; the much greater step has been to manage these accounts in the best interests of people on low incomes. For even though access to a bank account may indeed be for many a move into financial inclusion, for many others, a mainstream bank account has been the cause of greater financial exclusion and over-indebtedness. Recent research revealed, for example, that 26% of people taking out basic bank accounts in mainstream banks since 2004 have been net losers, and have been heavily penalised by penalty charges (Ellison et al, 2010b).

The challenge for credit unions was to offer people the kind of current account that responded to their particular needs for access, control, transparency and certainty about charges (Jones 2008a). Already, credit unions are committed to charging substantially lower fees for unpaid transactions than those of the banks, even though this is often compensated for by a small weekly account charge to the member. Encouragingly, research had indicated that the majority of low-income credit union members are ready to pay a reasonable upfront fee for a transparent, fair current account service (Jones 2008b).

The challenge for credit unions was to offer people the kind of current account that responded to their particular needs for access, control, transparency and certainty about charges

Even though most managers recognised the importance of a current account, the hurdle for all credit unions was to meet the high costs of introducing and managing The Credit Union Current Account. The entry charges are prohibitive for most credit unions, and given the current limited functionality of the account, there has been insufficient growth in take-up nationally to drive down regular running costs. Costs associated with operating the account can also rise due to support required by financially excluded members new to transaction banking. The three credit unions operating the Credit Union Current Account were supported by the DWP Growth Fund to meet entry charges but still do not expect the account to break-even for several years to come. The level of charges involved led two of the 15 credit unions interviewed to the conclusion that the introduction of a current account was not a strategic priority for them.

However, for others, the lack of a transaction banking service increasingly leaves them with significant operational difficulties. In some credit unions, Newcred Credit Union for example, there are growing numbers of members who have welfare benefits paid into their savings accounts and attend in person to withdraw cash. This is a high cost and high resource activity for credit unions and it is difficult to see how it could be maintained in the long-term.

The introduction of pre-paid debit cards is seen by some credit unions as a lower-cost viable alternative to the Credit Union Current Account. Pre-payment cards enable credit unions to offer their members a basic money transmission service. Loans and withdrawals can be uploaded onto a card which can then be used in a similar way to a debit card in ATM machines, on the internet and for telephone purchases, to pay for goods and to obtain cash-back in shops. Some pre-paid debit cards on the market can be expensive for members. Recently, however, ABCUL has introduced a card, specifically designed for credit unions with more affordable transaction charges. Several London credit unions are considering introducing a pre-payment card, given their inability to meet the costs of introducing the Credit Union Current Account.

The use of a pre-paid card does offer small credit unions the solution to an immediate problem. However, in the longer term, they cannot be seen as a substitute for a fully functional current account. Not only do pre-paid cards offer limited functionality to the member but they add administrative burdens onto the credit union, particularly in the area of liquidity management.

Driving down costs on the entry and operation of the Credit Union Current Account is a key strategic issue for credit unions in London, as elsewhere. This could be assisted with the possible introduction of ABCUL's back office initiative (see Section 2.9). Also, in 2012, The Co-operative Bank is introducing a banking transformation programme, which will improve the functionality of the account to include such elements as internet banking. It is envisaged that this should increase the attractiveness of the account to a wider segment of the market and thus contribute to reducing costs.

Budgeting and bill payment accounts

Effective support and assistance for low-income credit union members often can include some form of budgeting and bill payment mechanism to ensure that funds are put to one side to pay future bills. In fact, one reason that people often do not want to use a bank current account is the fear of unprovided-for direct debits, which incur charges and put people into debt. If they can be assured that funds are safeguarded and set aside to pay bills, then the process of transition to a current account can be easier.

There is a clear business opportunity for London credit unions to link the development of the Credit Union Current Account with a Credit Union Budgeting Account, which would offer people the certainty and security they seek. Even given fear of the loss of control with a bank account, most people realise the limitations of managing in cash or with just a POCA and, if offered an appropriate account, would migrate to transaction banking.

In London, there appear to be some informal arrangements around budgeting and bill payments, but no fully functioning budgeting and bill payment service was noted in the interviews. A Credit Union Budgeting and Bill Payment Account could be an important support mechanism in assisting people to migrate successfully to a Credit Union Current Account.

The centrality of personal finance education

Credit unions are in a key position to provide personal finance education that can empower members to make informed financial choices. They are in close contact with people on low and moderate incomes, often based in the heart of local communities, and have the trust and the confidence of the membership. Throughout the world, the success of credit union interventions to promote the financial independence, security and inclusion of their members has often depended on the level of personal finance education offered alongside access to products and services. Alternatives Credit Union in the US, for example, that developed the concept of the Credit Path, found that financial education is often "the key to helping members move more swiftly, but securely, through the process of building financial strength without unnecessary risk" (ACU, 2011). It is for this reason that ABCUL has promoted credit union involvement in personal finance and financial capability initiatives.

In the interviews, London credit union managers made references to credit union involvement in financial education initiatives, often in partnership with housing associations and money advice agencies. Greenwich Credit Union, for example, noted that it was involved in delivering personal finance workshops for members. However, for credit union managers, personal finance education did not primarily concern courses and training events. It concerned the information, knowledge and financial awareness communicated directly through the conversations and dialogue with members. Personal finance education was often informal and took place when staff and volunteers, in loan interviews and in interactions at collection points, raised issues and discussed the financial questions that arose immediately from members' own financial situations.

However, it is perhaps also true to say that not all staff and volunteers recognise the importance of the quality of conversations and interactions with members. Informal personal finance education in credit unions would merit further exploration; for it is often the personal encouragement to save and to borrow wisely that supports members to progress along a path to financial stability.

Driving down costs on the entry and operation of the Credit Union Current Account is a key strategic issue for credit unions in London

2.3 Economic and organisational challenges

The ability of credit unions to expand the provision of affordable credit and of financial services within low-income communities depends ultimately on their economic strength, organisational capacity and operational efficiency. It turns on their ability to attract savings, on their effectiveness as lenders, on their control of bad debt, on their generating sufficient income to sustain and develop operations and, like any financial institution, on their building institutional capital reserves to assure their long-term safety and stability.

In interviews, managers were clear that the ability of a credit union to expand services and reach out to an increasing numbers of Londoners in low-income communities, depends not on greater access to external subsidies, but ultimately on the credit union's strength as a sustainable and viable co-operative business. All managers maintained that if credit unions are to realise the social goal of serving people with little or no access to affordable financial services, they first have to achieve their economic goals of income generation and adequate capitalisation.

However, to varying degrees, all credit union managers reported that they faced significant financial and organisational challenges in building the credit union business. Specific challenges depended, of course, on a credit union's business model, on its stage of development and on operational performance. For some credit unions, the challenge was to assure resources to expand operations and to serve new markets. This could mean ensuring sufficient capital for on-lending and funding expansion. However, for others, the challenge was more immediate and related to making ends meet and ensuring the survival of the business. In fact, the majority of managers identified their greatest financial challenge in terms of revenue and income generation in order to ensure ongoing capacity to serve people on low incomes and those excluded from mainstream financial services.

The ability of credit unions to expand the provision of affordable credit and of financial services within low-income communities depends ultimately on their economic strength, organisational capacity and operational efficiency

Reducing dependency on external subsidies

There are a significant number of credit unions that are not yet generating sufficient income from lending or from other income generating activities to develop the business. Many are dependent on external subsidies or revenue, whether from the Financial Inclusion Growth Fund or elsewhere. Where external subsidy or revenue was not forthcoming, credit unions were often left unable to hire sufficient paid skilled managerial staff, with insufficient resources to develop new products and services, with poor IT systems and inadequate premises. In some cases, where credit unions had accessed Growth Fund revenue or other external financial support, the impending loss of this revenue left them vulnerable to closing down services for some of the poorest members of society or even to closure. Where the membership and loan portfolio had been built up with external financial support, but where the business was not yet large enough to generate income to cover all costs, it was hard to see how services could be maintained once external financial support was curtailed.

The Growth Fund has brought significant capital investment into credit unions and enabled a significant growth in membership and in the loan portfolio. However, it was stressed by managers that capital investment per se does not assist in meeting the costs of operations unless that capital generates sufficient income through productive lending. At least one credit union had seen Growth Fund capital allocated for on-lending eroded as it was used to cover expenditure necessary to keep the business afloat. This remains a risk for all Growth Fund credit unions if, after Growth Fund revenue ends, they are not able to cover operational and development costs out of earned income.

Income generation and expenditure

Statistical PEARLS²⁷ analysis of credit union financial statements for the year end 2009, indicated that out of the 10 Growth Fund credit unions for which data was available, 50%

²⁷ Originally developed in Latin America by WOCCU as a means to evaluate the performance of credit unions, PEARLS is a sophisticated financial management tool capable of measuring key areas of credit union operations, both in terms of financial structure and growth (Richardson 2001). It has been adopted by ABCUL as the standard statistical methodology for the British credit union sector.

had recorded negative net income to average assets ratios on the year's trading, with one credit union recording an exceptional negative net income to average assets ratio of -30%. Of course, these net "losses" were covered by grant and other external revenue income, but without this external income, these credit unions would have faced significant difficulties.

The challenge is not just to generate income, but also to retain it through control of expenses and bad debts. The negative net income to average assets ratios are explained primarily by high operating expense to assets ratios and by bad debt losses on the loan portfolio. For the 10 Growth Fund credit unions considered, all had operating expenses to asset ratios in excess of the 5% recommended by the World Council of Credit Unions. Nine had operating expenses exceeding 10% of average assets and four in excess of 15% of assets.

High operating expense costs, however, are endemic to serving high-maintenance, and often high-risk borrowers, with small value loans. As managers explained, costs are high because of the amount of staff time involved in credit assessment; in supporting more vulnerable members and in ensuring face-to-face service delivery, often particularly valued by low-income members. Costs also rise in making loan disbursements and collections in cash, as cash itself costs in the additional administration involved and in the secure delivery to a credit union from a bank. Costs rise also from the increased demands of credit control, of loan loss recovery and of bad debt write-off. In London, managers noted that there were often additional costs to service delivery as, for growing numbers of credit union members, English is not the first language.

Research undertaken in 2008 in two moderately-sized, staff-run credit unions (Jones 2008) offered a detailed analysis of the costs involved in serving high-maintenance, high-risk members with low-value loans at the maximum 26.68% APR interest rate. In the first credit union, on a £300 loan, even adopting the very strictest of marginal costing models, the income generated ranged from a loss of £39.60 to, in the best possible case based on monthly electronic payments, a surplus of £20.36. If fully recovered costs were considered, then it was impossible to recover the costs incurred in raising and administering the loan. In the second credit union, the loss on a typical £300 loan was £30.41. Similar costing structures are to be found in Growth Fund and other credit unions in London, and it is therefore not difficult to understand the importance of the external subsidy to credit unions reaching out to particularly hard-to-serve, high-risk, low-income markets.

High operating expense costs, however, are endemic to serving high-maintenance, and often high-risk borrowers, with small value loans

The impact of bad debt

Significant costs can arise from the impact of bad debt, and this was raised as a key issue by credit union managers. Of the eight credit unions currently delivering the second phase of the Growth Fund, seven had kept below the DWP target 10% bad debt ratio (measured as the ratio of those loans with no payment for 13 weeks as a proportion of the total Growth Fund loan book) and four were below 5%. 87% (seven out of eight) of credit unions with less than 10% delinquency was regarded as good performance, and exceeded the DWP quoted national figure of 70% of all contractors achieving a 10% bad debt ratio (as of November 2010).

However, from statistical PEARLS analysis, on the wider loan book, bad debt was somewhat higher. This is to be expected as PEARLS calculates bad debt differently to the DWP and includes all loans including those more than six months in arrears (these loans are written-off on the Growth Fund loan book). Of the seven credit unions which had delivered the Growth Fund for which PEARLS data was available, two had an overall bad debt ratio less than 10%, a further four were less than 15% and one around 18%. Of non Growth Fund live-or-work credit unions, for which data for nine was available, six had bad debt ratios less than 10%, a further one less than 15%, another less than 20%, and one had a bad debt ratio of near 30%. Overall, the average bad debt PEARLS ratio for live-or-work credit unions was 11.7% and for Growth Fund credit unions around 9%.

The inevitable conclusion is that bad debt is highly problematic for some credit unions, a bad debt ratio of 30% or even 18% poses major problems to the business. However, more positively, most London credit unions seem to have controlled bad debt fairly satisfactorily given the market within which they mostly operate. The indication that bad debts on Growth

Fund loans are somewhat lower than on the wider loan book aligns with managers reporting that Growth Fund members often repay loans better than borrowers in general; and with DWP business managers noting that significant advances have taken place in regard to credit control in London. In most London credit unions, credit administration always involves credit checks and rigorous loan assessment. This improvement owes something to the regular and consistent monitoring of the Growth Fund loan book by the DWP and the support given to introduce more robust credit control procedures over time.

Significantly, from statistical PEARLS analysis, it emerged that overall bad debt, as a proportion of total assets, was about 50% less in Growth Fund credit unions than in other live-or-work credit unions in London (8.83% to 16.79%). These ratios, as generated by PEARLS, have to be taken with some caution, as it is not easy to verify the robustness of the bad debt declarations by credit unions. However, it does seem the case that Growth Fund credit unions have performed better than other credit unions overall within the sector. This finding however must not downplay the seriousness of bad debt in some credit unions. As one manager noted, “There are credit unions that still fudge the issue of bad debts”.

Pricing low-value loans

The high cost of delivering low-value loans to low-income, high maintenance borrowers appears to arise more from the staff time involved in administering the loans, from the costs associated with cash handling, and from face-to-face service delivery and member support, rather than from the bad debt accumulated on the loan book. Making adequate provision for bad debt is central to credit union financial stability, but, as is clear from the costs involved in delivering the service, so too is a more rigorous approach to costing for low-value and high maintenance lending and, indeed, for overall service delivery.

Most managers accepted, given the impending withdrawal of external funding, that there was an urgent need for credit unions to revise pricing to cover costs. All those interviewed were in favour of raising the credit union ceiling on interest rates on loans from 2% to 3% per month (26.8% to 42.6% APR), even though most felt that it should not be any higher or removed altogether.

Managers were of the opinion, however, that an interest rate rise would make a significant difference to the credit union’s bottom line, without necessarily impacting too greatly on the level of a member’s weekly payment (see Table 3). Increasing the APR rate to 42.6% on a £400 loan over a 52 week period, would only make a weekly repayment difference of 51 pence to a member. Some managers felt that this interest rate rise could be introduced easily, either as a flat rate or through the introduction of set-up fees, the cost of which has to be included in an APR rate. The reaction of board members, however, to a possible interest rate rises was not tested and some managers indicated that the suggestion of an interest rate rise could cause a lively debate at board meetings.

Table 3
Impact of different interest rates on a £400 loan repaid weekly

Monthly interest rate	APR	Loan amount	No. of payments	Paid	Each repayment	Total amount repaid	Total interest payable
2%	26.8%	£400.00	52	weekly	£8.67	£450.84	£50.84
3%	42.6%	£400.00	52	weekly	£9.18	£477.36	£77.36
4%	60.1%	£400.00	52	weekly	£9.71	£504.92	£104.92
5%	79.6%	£400.00	52	weekly	£10.26	£533.52	£133.52

Of the eight credit unions currently delivering the second phase of the Growth Fund, seven had kept below the DWP target 10% bad debt ratio

Driving down costs through efficiency in systems and procedures

As well as raising prices, credit unions were conscious that they also needed to drive down costs. This was a key issue for managers, and credit unions are increasingly giving thought to developing more efficient systems and procedures, and to introducing electronic delivery channels to reduce staff costs in branches and elsewhere. The introduction of the Credit Union Current Account, pre-paid debit cards, internet websites and the use of text messaging services in the drive to modernise and streamline the business aims to offer a better service to members, but also aims to drive down credit union costs.

Driving down costs is a major challenge for credit unions, many of which do not yet have the necessary skills, experience or resources to make rapid progress in organisational change and reengineering the business. It is here that credit unions could benefit from expert technical assistance to carry out systems and process analysis to introduce efficiencies and to identify how savings could be made. There is a role here for banks, local authorities and other outside agencies to support credit unions in the assessment of performance, in the identification of organisational risks and weaknesses, in strengthening operational capacity and in improving processes and procedures.

Cash handling and disbursements are clear examples of high-cost activity. Newham Credit Union, for example, disburses thousands of benefit payments each week, mostly at a cost to the credit union, despite the recent introduction of a weekly £4 charge for a welfare benefit deposit account. The credit union is not yet in a position to afford the Credit Union Current Account, which would assist in cash transmission, but still needs to introduce greater efficiencies into the system. Even credit unions operating the Credit Union Current Account, introduced often to drive down costs, require support in implementing efficiencies, as experience is often that the administration of the current account has resulted in its becoming an additional cost to the credit union, rather than an evident cost saver, at least in the short term. Within the financial plan of many credit unions, it is not expected that the Credit Union Current Account would break even for at least five years.

In recent times, to enhance capability and to drive down costs, some credit unions have sought to join up with, or transfer engagements to, another credit union. North West London Credit Union, for example, is the result of Watling and Grahame Park Credit Union, Barnet Employees Credit Union and Finchley Credit Union coming together. Another solution for some credit unions has been to contract out all administrative and operational management functions to an independent company. However, such initiatives do not always necessarily result in cost savings without a rigorous assessment of systems and processes, which often credit unions do not have the capacity or the experience to undertake.

Developing information technology

The need to improve systems and procedures to promote efficiency and drive down costs led to general discussions on the development of information technology within credit unions. Credit unions use a range of accounting software, some have installed computerised information and administrative systems and several have websites that can handle balance enquiries and loan applications. However, the level of use and development of information technology within credit unions is, however, variable and in many cases limited.

It was clear from discussions that a successful credit union will need to invest in information technology to ensure the effective credit assessment of loan applications, the control of bad debt and the management of loan portfolios, as well as the computerisation of administrative information systems. Undoubtedly, the process of modernisation will depend on the increasing introduction of online access and the development of card services which are now standard throughout the financial services sector (see Section 2.6).

Credit unions, however, have limited resources and to be able to make significant advances in the installation of information technology, they would need the support of the Government or other external agencies and be prepared to pool and share resources (See Section 2.8).

Driving down costs is a major challenge for credit unions, many of which do not yet have the necessary skills, experience or resources to make rapid progress in organisational change and reengineering the business

Ensuring effectiveness in lending

The pricing of loans and other services and the introduction of more cost efficient systems and procedures are major challenges to credit unions as they consider expansion. However, there is yet another major challenge. For many credit unions in London, the lending business is often not performing at a rate or a size to generate sufficient income to cover all costs. External grants and subsidies have funded expansion, supported the hiring of staff and often assisted in the opening of new premises. But even with capital funds to on-lend, a credit union still requires a sufficiently robust, well-performing business lending model to turn those funds into the income which will free the organisation from grant dependency.

At the heart of the matter, and at the centre of all considerations in regard to strengthening credit unions, is the productivity of the loan book. Bob Hoel (2007) in his research into mid-size and small thriving credit unions in the United States identified that star credit unions outperformed others ('the laggards' [sic]) in nine key areas, the first of which was in the area of lending. Star credit unions are highly effective lenders, demonstrated by high loan to share or asset ratios. Credit unions that are able to lend successfully generate income, and, if they control expenses, are able to achieve financial stability.

In London, from statistical PEARLS analysis of loan to assets ratios, there were both "stars" and "laggards". Among Growth Fund credit unions, loan to asset ratios ranged from 84% to 19%, the average being 57%. Among non Growth Fund live-or-work credit unions, the range was from 90% to 6.5%, the average being 56%. The World Council of Credit Union recommends that 70% – 80% of assets need to be out on loan in order to achieve financial stability. Of 11 Growth Fund credit unions for which data was available, only two were in this category even though a further four had ratios over 60%. Two credit unions were under 40% of assets lent. Of the 11 non Growth fund credit unions, five had loan to asset ratios over 70%, another over 60%, the remaining five credit unions had ratios under 45%. Credit unions with less than 50% of their assets are in normal circumstances are going to struggle to make ends meet. Of course, low loan to assets ratio also meant high liquidity ratios, given that funds for on-lending were not yet lent out and not, clearly, generating income.

At the heart of the matter, and at the centre of all considerations in regard to strengthening credit unions, is the productivity of the loan book

Refocusing the credit union business

In order to develop and diversify the loan portfolio, and indeed maximise savings, all credit unions interviewed were keen to refocus the business to serve a wider segment of low and moderate income market. All stated that the credit union target market cannot be based on serving low-income, high-maintenance individuals alone, for this does not offer the opportunity of building a sufficiently large and robust loan book. Even if interest rates were raised to 3% per month on low-value loans, it would still be difficult to sustain the business operating solely on the basis of low-value, high-maintenance loans. It was accepted that credit unions need to offer a wide range of affordable loans, at competitive interest rates, to attract a sufficient range of borrowers to build the business. Experience from overseas supports this approach. In the United States, for example, community development credit unions, which have a mission to serve low-income communities, do not build the business on low-value loans alone; in fact a large part of their income comes from high-value equity loans made to low and moderate-income people to enable them to access affordable housing.

Credit union managers wanted to transform the image of credit unions in London to be regarded as mutual and co-operative financial institutions acting in the interests of all, but with a focus on those on low and moderate incomes. There was no suggestion that they wanted credit unions to move away from disadvantaged and poor communities. The commitment to serve this market was strong and was stressed repeatedly by several managers. However, they wanted to broaden the scope of credit unions so that they would no longer be regarded as institutions solely for the poor, but rather as inclusive financial providers, within which those on low incomes and the financially excluded could be best served. It was stressed that building the business among more profitable segments of the market cross-subsidised lending activity in lower-income communities.

The key action underpinning this strategy to broaden access to credit unions was the move to maximise payroll deduction agreements with local authorities, primary care trusts, government departments, companies and organisations. Payroll facilities were seen as critical to long-term sustainable development, and a number of credit unions made payroll deduction agreements with employers a major priority. Newham Credit Union, for example, had pioneered a new loan product specifically for Council employees, only possible through payroll deduction repayments. This was designed specifically to generate income to compensate for loss of external subsidy and to sustain services to the financially excluded.

Building institutional capital

London credit unions are at different stages of development. Clearly, some are still highly dependent on external subsidies, but others are already financially self-sufficient and yet more are transitioning towards self-sufficiency. Statistical PEARLS analysis indicated that among the 11 Growth Fund credit unions, for all but two, dependence on external income was declining. Several credit unions that had been highly dependent on external financial support reported that they were now covering 60 or 70% of their costs out of earned income. On the basis of this progress, a number of the managers interviewed were endeavouring to convince external funding bodies to maintain financial support to cover this reducing short-fall, in order to sustain the delivery of affordable credit to low-income communities.

The financial challenge was particularly acute among new credit unions. A number of these credit unions were established with significant external subsidy, often from local authorities or regeneration agencies, to serve the financially excluded and low-income communities. They were organised according to a business model that depended on visible, high street premises, professional staff and a range of quality services from the outset. These credit unions were a high-cost investment and, despite being able to reach out to large numbers of financially excluded individuals, often had not yet developed the business sufficiently to achieve financial stability. These credit unions had very high external income to asset ratios and were very vulnerable to the loss of grant or revenue support. Without additional support or significantly driving down costs, they would have to consider transferring to another credit union or closure. It was argued that achieving financial sustainability within three years, often the period for which external subsidies were secured, was perhaps unrealistic.

Statistical PEARLS analysis, however, revealed a further concern in regard to the long-term sustainability of many London credit unions, not just the new credit unions. Overall, credit union institutional capital to assets ratios were low²⁸. Clearly, in the challenge to make ends meet, many credit unions have not had sufficient surplus resources to build their capital adequacy. Of the ten Growth Fund credit unions for which data was available, at year end 2009, eight credit unions had capital to asset ratios of less than 2%. Currently, of course, there is only a FSA requirement for a credit union to have positive net worth, with which all Growth Fund credit unions complied, unless of course credit unions have over 5,000 members when the required ratio is 5%. However, 2% capital to assets ratio is below the minimum 3% prudential standard for all Version 1²⁹ credit unions that will be phased in over 3 years (1% in the first year, then 2% then 3% by year three) by the FSA from 2011. Growth Fund credit unions, however, will mostly receive an injection of institutional capital when they are able to capitalise Growth Fund capital at the end of the Growth Fund in March 2011, and this will enable most to reach or exceed the 3% figure. However, unless income is increased, and expenditure reduced, this capital will be eroded over time. Non Growth Fund credit unions had slightly higher ratios, and of the 11 credit unions for which data was available, three had capital to asset ratios higher than 10%, a further two had ratios over 5%, and a further two over 3%. Two, however, had negative ratios and were technically insolvent (one of these credit unions is transferring into another larger credit union). Employee credit unions had a sector average of 2.97%.

²⁸ It is to be noted that PEARLS only looks at statutory reserve, and does not include other reserves that the credit union may have, including Growth Fund capital or subordinated debt. Capital adequacy for FSA purposes may therefore be higher than PEARLS suggests. The capitalisation of Growth Fund capital will increase credit union capital, even though this has not been built through earned income.

²⁹ Credit unions can either register with the FSA as Version 1 or Version 2 credit unions. Version 2 credit unions are subject to more stringent capital, liquidity and supervisory requirements, but can offer a wider range of loans and savings products to members. All live-or-work credit unions in London are currently Version 1 credit unions.

Credit union managers wanted to transform the image of credit unions in London to be regarded as mutual and co-operative financial institutions acting in the interests of all, but with a focus on those on low and moderate incomes

Assuring funds for on-lending – a focus on savings maximisation?

Credit unions generate funds for on-lending through attracting the savings of their members. Internationally, they operate a traditional retail banking model and are risk averse. Unlike banks, they do not seek out funds for on-lending through trading on the wholesale money market. The recommendation of the World Council of Credit Unions, which is standard throughout the sector, is that 70% – 80% of the total assets of a credit union should be made up of savings deposits. This foundation on members' savings has enabled credit unions world-wide to weather much of the fallout of the international financial crisis.

However, whilst generating savings to on-lend protects credit unions from risk, as they are free from dependency on fluctuating money markets, it arguably also slows down growth, particularly within low-income communities. Raising funds rapidly from savings alone to fund credit expansion, particularly from a low-income membership, is not easy. Savings take time to accumulate and, even if a credit union is able to attract the savings of an economically diverse membership, it is difficult to reach the levels of funds required to meet new and expanding loan demands speedily.

The impact of accessing funds for on-lending other than from members' savings has been demonstrated most markedly with the Growth Fund. The Growth Fund capital investment fuelled a major expansion of the creation of affordable credit throughout London, and built credit union membership in a way that just would not have been possible if credit unions were reliant solely on funds generated through the savings of their members.

The issue of the creation of credit is at the heart of any discussion of the expansion of access to affordable credit in London. Notwithstanding improvements in systems and procedures, and the strengthening of credit union governance and organisational structures, without access to significant funds (capital) to on-lend, the expansion of access to affordable credit is undermined. At least one credit union raised this issue of access to capital for on-lending as its greatest financial challenge. Without access to funds for on-lending other than the savings of members, London Mutual Credit Union envisaged that it would be problematic to fund a rapid expansion of affordable credit into new and emerging markets.

There was no suggestion from managers that credit unions should move away from their primary focus on the generation of funds for on-lending from the savings of their members. All managers were keen to stress the high importance they placed on promoting saving, both for the personal economic benefits of members, and also for the long-term stability of the credit union. Statistical PEARLS analysis demonstrated the credit union dependency on savings deposits for on-lending; savings deposits to total assets ratios in 2009 in live-or-work credit unions was 85%, in employee based credit unions was 92% and in Growth Fund credit unions was 68%, this lower ratio the result of Growth Fund capital investment.

However, there was also from some credit unions, as with London Mutual Credit Union above, a concern that funding the expansion of access to credit throughout London would require access to funds over and above the savings of members. One credit union, for example, had received a substantial subordinated loan from a local authority, which significantly assisted the credit union to develop its lending business.

However, the concern to identify additional funds to on-lend came mainly from credit unions with high loans to assets ratios. These were the credit unions that were effective lenders. For credit unions with lower loans to assets ratios, the issue of identifying further capital to on-lend was not as pressing, neither was the perceived need to maximise savings. These were cash rich credit unions and their greatest challenge remained to build the loan portfolio, both to put existing capital to use within the membership and in order to generate income.

There was another important aspect to the credit unions' consideration of identifying additional funds to on-lend over and above savings. The Growth Fund did not just supply capital to on-lend; it accepted all the risk associated with the lending. If things went wrong and bad debts soared, the credit union risked being put out of the programme but it did not risk any of its members' savings or its own capital reserves. This acceptance of risk by the Growth Fund enabled credit unions to reach out into often unexplored and higher-risk low-income

*Credit unions
generate funds for
on-lending through
attracting the savings
of their members*

markets. The Growth Fund gave credit unions the confidence to reach out to people on low incomes who would not normally have taken steps themselves to join a credit union.

New savings mobilisation and funding opportunities

Building a credit union's lending portfolio on the basis of the savings of the members is central to successful credit union development (Richardson 2000) and, as was stressed in the research study consultation group, there are no examples world-wide of credit unions establishing themselves as viable financial institutions long-term on the basis of externally generated funds. In fact, wherever this has been attempted, as sometimes in Latin America, it has mostly resulted in credit union failure (Jones 2004).

The primary challenge, therefore, for credit unions endeavouring to expand access to affordable credit is to maximise the savings of members. London credit unions have taken a variety of approaches to building savings; a number retain a default obligation to save whilst repaying a loan or as part of the condition of membership, whilst others have divided loans from savings altogether and rely on attracting savings through the variety and quality of the products on offer. Most credit unions also pay a dividend on savings comparable to what is currently being paid by banks and building societies on small savings. In 2009, Islington and City Credit Union, for example, paid 1% on savings, London Mutual Credit Union also paid 1% as did Lewisham Plus Credit Union. Some credit unions, however, because of financial constraints, find they are unable to pay a dividend each year.

Growth in savings in London credit unions is variable. In the year 2008/2009, savings overall increased by 23%, up on the 9% recorded for each of the years 2007/2008 and 2006/2007³⁰. In Growth Fund credit unions, the increase in 2008/2009 was 12.73%, similar to the previous year's 12.84%, but up on 2006/2007 at 8.99%. However, this overall figure masks divergence in savings growth in individual credit unions. At least one of the largest London credit unions, in 2008/2009, only grew savings by around 7%, a rate insufficient to support rapid credit expansion into new markets. Growth Fund credit unions, however, in recent years have outperformed other live-or-work credit unions whose rates of growth were 9.88% for 2008/2009 and 5.64% for 2007/2008. On the other hand, employee credit unions in the year 2008/2009 increased savings by over 38%, up significantly on the 8.89% in 2007/2008. However, this owes much to the increase in savings in one credit union, Plane Saver Credit Union.

By year end 2009, Growth Fund credit unions had approximately £15 million in savings, a 12% increase on which would amount to £1.8 million. To expand access to affordable credit throughout the whole of London, particularly in underserved areas, this amount appears modest, and it is for this reason that credit unions need to continue to prioritise and to put a great deal of energy and drive into the maximisation of savings. The new legislative reform order³¹, expected to be implemented in 2011, will offer credit unions a range of new opportunities that will help to maximise savings. Common bond definitions will be relaxed enabling credit unions to serve many more members. They will be able to pay interest on savings deposits rather than just a dividend, which will make credit union savings accounts a much more attractive proposition, and they will also be able to serve groups and corporate bodies that will also be able to make savings deposits.

There was significant interest among managers in the possibility of corporate deposit funds. Corporate membership will enable corporate deposits of up to 25% of the total deposits in a credit union; each individual deposit can be up to a maximum of £10,000 or 1.5% of the total non-deferred shares in the credit union. It was felt that corporate deposits could turn out to be a significant source of funds for on-lending and could be an attractive proposition for organisations and agencies wishing work in partnership with credit unions.

Another new mechanism for savings generation created by the legislative reform order is deferred shares. These are a particular form of savings (shares) which have the particular advantage that they count towards the capital of the credit union. They are transferable but

³⁰ Savings growth figures are based on the annual financial returns for 32 credit unions in London, including 11 Growth Fund credit unions, 8 live-or-work credit unions, 8 employee credit unions and 5 associational credit unions.

³¹ Legislative Reform (Industrial and Provident Societies and Credit Unions 2010)

Building a credit union's lending portfolio on the basis of the savings of the members is central to successful credit union development

non-withdrawable and are not covered by the Financial Services Compensation Scheme. These long-term at-risk deposits directly strengthen a credit union, building its institutional capital, and could be highly significant in enabling a credit union to develop. However, managers interviewed were unsure how individuals or organisations would view such a mechanism and how it could be promoted. Deferred shares, however, would enable organisations to make a significant long-term investment in credit union stability, from which they could also receive income from interest payable on the deposits.

Raising funds for on-lending, other than through savings mobilisation, was regarded by some managers as still an important issue, and was essential if new and emerging low-income markets were to be served with affordable credit rapidly and extensively. Even though the credit union business model focuses on building member savings, credit unions are allowed to borrow money from a corporate body which could be used to finance on-lending. A credit union can take out subordinated loans, which provide regulatory secondary capital, or loans which provide ordinary funding. Version 1 credit unions, and all credit unions in London are Version 1, can take out ordinary loans that do not exceed, except on a short-term basis, an amount equal to 20% of share capital (i.e. members' savings deposits), and version 2 credit unions up to 50% of the 'total shareholding in the credit union'³². Subordinated debt is not included in this restriction.

Several credit unions in London already had subordinated loan arrangements, which at least in one case had funded a significant expansion of the loan book. This subordinate loan was £0.25 million investment into the credit union by a London local authority. Subordinated loan opportunities are an area for greater exploration and, unlike deferred shares, they do offer the lender the return of the capital at the end of the agreed period (at least five years). They are a useful and important mechanism through which organisations are able to directly support the capitalisation and expansions of credit unions. They could be of interest to housing associations, local authorities, charitable trusts, the Big Society Bank, among others³³. Often subordinated loans are made at no interest to credit unions, but this need not necessarily be the case, and external investors may be more interested in investing if credit unions paid a return on such investment.

In relation to ordinary loans, there were no examples that surfaced in the interviews of credit unions borrowing commercially from banks or other institutions in order to fund on-lending. Nevertheless, some credit unions that owned their own premises did contemplate the possibility of borrowing against the property in the future. However, the fact that credit unions can legally borrow opens up the possibility to banks and other organisations to support the development of the sector, and of widening access to affordable credit. Traditionally, banks may not have seen credit unions as sufficiently secure organisations into which significant investment could be made. However, the success of the Growth Fund and the pressure on banks to open access to credit in low-income communities could result in banks taking a different view. There are good arguments for banks to lend to credit unions at preferential interest rates to widen access to affordable credit in low-income communities. As with subordinated debt, there may be a significant role to be developed here for the Big Society Bank and other organisations interested in making social investments into the sector.

Sustaining and developing operations

However, the mobilisation of savings or borrowings, either as subordinated debt or normal loans, will not resolve the immediate problem that some London credit unions face of a lack of revenue to sustain operations at the present level within low-income communities when much external grant funding ends in 2011. Despite current public sector spending restraint, there is a good argument for Government, local government and others to ensure that sufficient ongoing revenue support, or grant aid, is made available to near-sustainable credit unions to enable them to achieve financial stability, and to other more economically vulnerable credit unions to assist them to transfer engagements into neighbouring credit unions.

³² See, FSA CRED Sourcebook 7.3 Borrowing and Financial risk management.

³³ Note – subordinated loans from public bodies count as state aid so this limits how much can be raised in this way.

The new legislative reform order, expected to be implemented in 2011, will offer credit unions a range of new opportunities that will help to maximise savings

Otherwise, much that has been gained in the development of the credit union sector is in danger of being lost. Recent research into the effectiveness and efficiency of credit unions has arrived at a similar conclusion:

“Fundamentally, there is little doubt about the continuing need for the sector as a whole to attract forms of external support if more credit unions are to reach the ideal of financial independence over the course of the next decade.” (Hope 2010).

However, as important as the continuation of external financial support is for some credit unions at the present time, it is likely that any ongoing external funding will only be an interim short-term measure. Contrary to Hope (2010), it is hard to envisage large scale external financial support or grants being made available to credit unions for their own individual development over the course of the next decade.

Building the financial and operational strength of London credit unions so that they can take a lead in the expansion of affordable credit and other financial services in low-income communities will require a radical new approach to the credit union business, and to the way external financial support comes into the sector. London credit unions are increasingly coming together, through transfers of engagements, to achieve economies of scale and this is likely to continue into the future. Credit unions are already recognising that developing individual credit unions as totally separate entities is high-cost and often confusing to the general public with the varied range of products and services on offer. In later chapters, this report will argue that a more collective and collaborative approach to product and service development offers individual credit unions a much greater opportunity to build a common vision and identity in London, to attract a more economically diverse membership, to establish strong working relations with partners, and to assure the long-term stability of the sector overall.

The building of effective collaborative systems depends, however, on modern information technology and on sophisticated back office facilities and, as is argued in Section 2.9, it is in this area that external grant aid into the credit union system may be best placed.

However, even if credit unions collaborate effectively on products and services, this does not on its own solve one of the most difficult challenges associated with the expansion of affordable credit in low-income communities. As has already been argued, the delivery of low-value, high maintenance loans is expensive and, even with an interest rate rise of 3% per month and effective cross-subsidies within the business, credit unions still may not be able to cover all the costs of administration and of the risks involved in opening up new low-income markets.

The importance of the Growth Fund to credit unions was that it not only provided capital, but that it also covered administration costs on a contractual basis and bore the risk of default. The two elements of contractual service delivery and of bearing or sharing risk are ones that could be built upon within future programmes. Already credit unions deliver products and services for local authorities, housing associations and others, to tenants and to defined groups, often on a contractual fee-paying basis. This is an area that could be developed. In order to promote and expand access to credit, there may be a role for banks and other organisations to develop risk sharing sub-prime loan guarantee programmes with credit unions operating in low-income communities. If credit unions are able to charge more commercial rates, the need to cover 100% of the risk in low-income, high maintenance lending may no longer be necessary.

There is a good argument for Government, local government and others to ensure that sufficient ongoing revenue support, or grant aid, is made available to near-sustainable credit unions to enable them to achieve financial stability

2.4 Leadership, governance and management

Credit unions in London have grown significantly, particularly since 2005, and are now increasingly recognised as co-operative financial institutions that are able to make an important contribution to the social and economic life of the capital. However, as this report has also shown, growth has not taken place equally in all credit unions. Some credit unions have expanded significantly, others are exhibiting potential to expand, whilst there are still yet others that lag behind or even seem to have stagnated.

Many of the factors influencing credit union growth have been identified in previous chapters; including access to financial and physical resources, particularly through the Growth Fund, competence and skills in lending, financial discipline, the control of bad debt, the support of local authorities and other partner organisations. However, it strongly emerged through interviews that the over-riding factor underlying successful expansion has been the leadership shown by particular directors and managers in driving credit unions forward.

Irrespective of all other factors, in the expansion of the provision of affordable credit and other financial services in London, entrepreneurial leadership matters. Where directors and managers have the vision, passion, motivation, confidence and the skills to make things happen, economic and organisational challenges have been overcome and real progress has been made. It is difficult to see how any credit union can expand access to financial services and attract a larger membership without having the directors and managers skilled and competent to lead a process of change.

The over-riding factor underlying successful expansion has been the leadership shown by particular directors and managers in driving credit unions forward

Good governance

The importance of good governance as distinct from management was thrown into relief as credit unions increasingly formalised the responsibilities of managers and paid employees. This tended to clarify the policy and strategic role of the board. In small, volunteer-run credit unions, responsibilities of directors and operational volunteers often overlap in a common endeavour and the specificity of role clarifications can be blurred. As credit unions employ staff, the specific governance role of the board takes on a more defined significance.

Many London credit union managers argued that there had been major advances in the understanding of the nature of good governance in the London credit union sector. Not only had this been facilitated by the increasing professionalisation of credit unions, but also by such initiatives as the ABCUL-formulated code of governance. They reported that there was an increasing involvement of skilled and professional people in credit unions as volunteer directors, including bank managers, housing directors, accountants, solicitors and business entrepreneurs. This had, they argued, strengthened the competence of boards of directors and led to much improved decision making in the boardroom. However, even on these strengthened boards, gaps in skills and experience can still remain on boards, as credit unions endeavour to respond to new strategic and business challenges.

Despite significant advances in the governance of some credit unions, there appeared to be still other credit unions where there was a lack of sufficiently-skilled directors to lead the organisation and drive a process of change. Many of these credit unions had been established by people of vision and with a passion to create a mutual financial institution for their community or workplace, but were now in need of a second generation of leaders who could move the organisation forward and cope with the strategic, organisational and financial challenges that credit union growth entails. The problem was that finding such new generation leaders was not always easy or straightforward.

The barriers to finding new board members often appeared complex. Potential directors could feel daunted by the level of responsibility involved in leading an expanding business and in coping with increasing regulatory requirements. Sometimes there could also be the reluctance of existing directors to welcome new ideas and ways of doing things. Some of the partner representatives, for example, spoke of the difficulties sometimes of potential new directors in negotiating access to the culture and ways of working of credit union boards. In some credit unions, boards may have virtually abdicated responsibility for credit union gov-

ernance to the manager, which can also be difficult for a new director to negotiate. In such cases, managers may have become the gatekeepers to membership of the board.

Ensuring good governance emerged, therefore, as a current and ongoing issue in varying ways and degrees for all credit unions in London. As has been explored in the previous section (Section 2.3), credit unions face significant economic and organisational challenges. Managers and partner representatives agreed that now, even more so than in the past, credit unions require the entrepreneurial leadership of effective boards if they are going to expand their services to increasing numbers of people in the capital. Widening access to credit union services will not just happen, even with significant external funding, without board members with the dynamism and skill to make change happen.

Management structures and systems

Alongside good governance, expansion of access to credit union financial services depends on the leadership of managerial staff who are able to implement effective management structures and systems. This was thrown sharply into relief in those credit unions delivering the Growth Fund. Credit unions with effective staffing and management systems tended to achieve loan and repayment targets, whereas those struggling and facing management difficulties tended to perform less well. Independent evaluation of the Growth Fund recognised that in order to deliver on target, 80% of Growth Fund lenders improved working practices and operated in a more business-like way (Collard et al., 2010).

In London, an increasing number of credit unions are led by professional managers and employ paid staff teams. In general, credit unions, established by volunteers, have learnt the lesson that effective service delivery demands the employment of professional staff (Jones 2008). London Mutual Credit Union now has a team of 35 paid staff and London Community Credit Union employs 24 paid staff members. In these credit unions, a management structure is evident, including the beginnings of an identified tier of middle management. The lack of a middle management structure in credit unions has often been raised as a concern in relation to their longer-term stability, and still remains a challenge for a large number of credit unions in the country. Greater formalisation of management structures not only enables credit unions to deliver services more effectively, it also offers the opportunity for employee development and career advancement, both of which contribute to the longer-term sustainable development of the organisation.

However, despite improved management systems, it was evident that even larger credit unions could still strain to cope effectively with an increasing demand for credit union services. In one credit union, the manager started each day at 7.30 a.m. to assist in the processing of benefit lodgement withdrawals in cash over the counter. In another, staff members were so busy that often incoming phone calls went unanswered. For managers, the demands of day-to-day operations were often so great that little time remained for more systematic strategic thinking and planning.

The high demand on systems and staff resources was even more evident in many smaller credit unions, which often reported difficulties in affording the costs of engaging professional paid staff. Credit unions reported how a lack of resources resulted in significant gaps in the management structure. It was often the manager or another key member of staff who had to fill these gaps, putting even greater strain on the organisation. Some credit unions could only afford a manager, maybe only part-time, and perhaps a number of part-time administrative assistants. It was not unusual for managers to be responsible for multiple aspects of the operations of the business, which then compromised more strategic responsibilities. A number of credit unions in West London found that they were unable to afford to staff the credit union at all, and it was more affordable to contract out all management functions and responsibility to an independent company, Credit Union Solutions. This was an immediate solution to a problem, but without staff of their own, there was perhaps the danger of these credit unions losing a sense of control of the business.

An additional strain on many credit unions was the fact that paid posts were often supported by external grants and subsidies, which, in a time of financial uncertainty, has left many credit unions feeling vulnerable about their future stability and ability to staff the credit union

Credit unions require the entrepreneurial leadership of effective boards if they are going to expand their services to increasing numbers of people in the capital

adequately. With externally-supported staff, credit unions have often grown the business to a level where it would be very difficult to return to an entirely volunteer-run organisation, but they are not yet generating sufficient income to cover all their staffing costs.

Given the challenges faced, it was noteworthy that credit unions in London were able to achieve so much with limited resources. Even though not assessed as part of the study, there were good grounds for believing that many credit union staff members worked beyond that which would normally be expected and that credit unions were strained to meet organisational demands. The problem is that the ongoing growth and expansion of financial services will entail even greater and higher level management resources. New skills and competencies will be needed in organisational systems, financial and asset management, credit administration and debt recovery, and human resources if credit unions are to develop as significant co-operative financial institutions serving large numbers of Londoners. Added to this will be the new administrative challenges that will arise through new regulatory and accountancy requirements, and the necessity of credit unions to meet increasingly rigorous operational standards of performance.

Strengthening credit union governance and management

In recent years, the credit union movement in London has participated widely in governance and management training. Since 2009, through ABCUL's Delta training programme, 50 separate credit union courses have been run in the capital involving around 600 directors, managers and staff members. In addition, ABCUL's e-learning programme has involved many more people in virtual training sessions. These courses have encompassed a range of subjects including director responsibilities, board development and performance, effective lending, human resource management, team development, financial accounting and analysis, customer service, risk management, and internal audit. Evaluation reports collated by ABCUL indicate the positive outcomes of such courses in regard to the building of skills and competences in the sector.

New skills and competencies will be needed in organisational systems, financial and asset management, credit administration and debt recovery, and human resources

But such training can only be one of the actions credit unions need to take to strengthen their governance and management. In regard to governance, it was stressed in research seminars that credit unions need to try harder to draw in a wide range of professional and skilled volunteers as board members. Gaps in knowledge and expertise on boards cannot always be filled by courses; rather it is often more appropriate to bring in new people who already have specialism and skills. It was argued that banks, social housing providers, local authorities and corporate businesses are well placed to support their skilled management and technical staff to volunteer in credit unions; indeed, some credit unions already have such individuals as board members. Their participation not only strengthens boards of directors, but also it builds important links between credit unions and other sectors.

Research participants argued the importance of a co-ordinated London-wide system of recruiting credit union directors. Credit union boards and managers do not always have the connections to approach new, highly-skilled individuals and a collaborative system of volunteer engagement is to be recommended. Managers and partner representatives felt that there needed to be appropriate, systemic induction for all prospective directors so that they understood the co-operative nature, culture and workings of credit unions.

In relation to participation on boards, social lender participants raised the issue of nomination to the board of a credit union. Often social lenders consider that their formal representation on a board would contribute to ensuring that financially supported credit unions were well governed. However, currently board members can only be elected in a personal capacity, and this was seen as not always appropriate for social lender representation. It was noted that this would possibly change with forthcoming legislation when social lenders, if they became corporate members of the credit union, would be able to nominate people for election to a board.

Strengthening the management of credit unions was seen to be critical to the long-term successful development of the sector, but was challenging as it necessarily involved addressing multiple issues simultaneously. Actions needed to be taken to ensure the adequate staffing of credit unions, the development of higher-level management and leadership skills, and the development of higher-performance organisational systems.

In respect to each of these areas, the following points emerged in research discussions:-

- **Adequate staffing** – This was an immediate problem for those credit unions which lacked the resources to employ sufficient professional staff, or whose external funding to support current staff was coming to an end. With external financial support for staffing, credit unions have often built the business to such a level that a return to an entirely volunteer-run operation would be near impossible but income is as yet insufficient to cover the full amount of staffing costs. There was a need in a number of cases to ensure the financial support for staffing in credit unions in transition to self-sufficiency in order to ensure their ability to manage the business effectively.

There are particular challenges in small organisations to ensure sufficient middle management and technical staff. Middle managers are required to ensure that credit unions do not become overly dependent on one or two senior staff and have long-term stability built within the organisational structure. High-level technical staff, in areas such as finance, human resources, marketing, and product development, are also difficult for smaller organisations to employ given the costs involved. Staffing solutions based on credit union collaboration or mergers is discussed in Section 2.8.

The recruitment of volunteer operational staff in credit unions remains an important issue for many credit unions. This is discussed within the wider context of volunteering in Section 2.5.

- **High-level management and leadership** – The challenge of developing credit unions into co-operative financial institutions, able to serve large numbers of people in London, demands a step-change in management and leadership skills throughout the sector. The need for entrepreneurial leaders, able to think and act strategically, appears as a priority if credit unions are to expand services throughout the capital. There is both a need for higher-level leadership development programmes for existing managers and for the recruitment of a new generation of skilled managers into the sector. The possibilities held out by collaboration approaches to credit union development may offer the best way forward to ensuring the required management expertise throughout the sector (see Section 2.8).
- **Creating high-performance organisational systems** – Improving the efficiency and effectiveness of credit unions have been a high priority for many credit unions in London. However, staff are still often under strain, undertaking time consuming routine tasks and functions. At this critical stage in the development of London credit unions, it is argued that major efficiencies and improvements in performance can only come about through a major strategic rethink and re-engineering of the organisational systems of the credit union business. As will be argued in Section 2.8, it hard to envisage how this could be realised without moves to greater collaboration, and to the introduction of sophisticated electronic systems.

Given the challenges currently being faced by credit unions in London (see Section 2.3), and the opportunities afforded by increased consumer and political interest in the sector, it was clear that improving the management and performance of credit unions was an urgent necessity. Success would not only depend on a vision and a motivation for change, but on the introduction of radically new ways of operating the business.

Strengthening the management of credit unions was seen to be critical to the long-term successful development of the sector

2.5 Voluntarism and a commitment to local communities

Credit unions are co-operative financial institutions governed by boards of directors elected by their membership. In London, as in the UK generally, all directors are volunteers, as are the large number of other unpaid individuals who regularly support or undertake voluntary roles and positions in credit unions. Voluntarism, or the dependence of credit unions on volunteers, was not regarded negatively by managers and partner representatives, as if it were just linked to a lack of funds to employ staff, but rather it was seen as a fundamental aspect of credit union engagement with the membership, with the community and with society at large. Overall, credit union managers were committed to the principles of volunteering and to maintaining an ethos of volunteering as unpaid activity.

The significance of localism

All credit unions in London emerged out of social and community networks through the actions of volunteers. This was true whether credit unions were established for a particular neighbourhood, for an employee group or for an association of people. London Mutual Credit Union, for example, was formed in 1982 as Southwark Council Employees Credit Union by a group of volunteers who had the vision of creating a self-help, financial co-operative for the economic advancement of their colleagues and workmates, most of whom were on low incomes (Decker and Jones 2007). A more recent example is Tower Hamlets Community Credit Union³⁴, created in 2002 with local authority support, but essentially by a group of volunteer directors committed to tackling poverty and exclusion their local area.

In research discussions, strong links were made between voluntarism, localism and community engagement. It was often volunteers who ensured that credit unions remained embedded in local communities and responsive to local needs. Most credit union managers spoke of the importance of directors knowing the community and having strong links and connections in the locality. For it was through this local network that credit union services could be developed and delivered to people who needed them the most. Most managers stressed that localism in credit union operations was highly valued and had to be preserved in any move to greater overall operational efficiency.

This same point was stressed by social housing participants, one of whom in a research group argued strongly that:

“Tenants relate best to local initiatives that reflect the culture and the ethos of their area. Very few tenants travel across London and they look for services that relate to their local social networks”.

In this respect, the research study confirmed previous research that many people on low incomes are attracted to community-based financial services, and are often best served by them rather than by the mainstream financial providers (Collard and Kempson 2005). It is for this reason that many credit unions in London have developed outreach services in community centres, church halls, Sure Start centres, housing offices, libraries and other community locations. For it is often through these local access points that people marginalised from the mainstream can be reached and brought into credit union membership. In common with many British credit unions, credit unions in London have a strong focus on local development and links with the local community.

The challenge of retaining a presence in the community

However, as referred to elsewhere in this report, some credit unions in London have found it difficult to preserve a presence in the community through local branches or outreach service points (See Section 2.6). Often this is due to a lack of financial resources and the need to make operational efficiencies and savings. Sometimes it is also due to a lack of sufficient paid staff or volunteers to staff multiple outreach points.

³⁴ Now London Community Credit Union Ltd.

Credit union managers were committed to the principles of volunteering and to maintaining an ethos of volunteering as unpaid activity

This has led some credit unions to move towards more remote delivery channels, with a few credit unions now accessed primarily on the phone or through the mail. Some partner representatives stressed that they considered that was the wrong direction to take. Clearly, remote and electronic delivery channels are essential to modern service delivery, and increasingly members needed to be educated in their use. Yet for many partner representatives that it is still important for credit unions to retain a local presence in order to reach people for whom a face-to-face service is essential.

It was argued, both by credit union managers and partner participants, that local government and partner organisations have a significant role to play in assisting credit unions to retain and to develop a local presence in the community. A good example of local authority support to develop a local credit union presence is the new London Mutual Credit Union branch in Brixton supported by Lambeth Council.

Building the local economic and social fabric of society

The primary and overriding purpose of a credit union is to provide accessible and affordable financial services to its members. However, in research discussions, it was stressed that credit unions have a much greater role in society than a focus on financial services alone might, at first sight, suggest. It was argued there was often a fine line between the provision of financial services and the impact of those services on the social and economic fabric of society. A loan can assist someone into work, or to set up an enterprise or, in many cases, to support the stability of a family. Access to an affordable loan can be a key factor in preventing people falling into over-indebtedness or into other forms of distress through not having to resort to high-cost credit options. Research has also demonstrated the social and psychological impact of saving in the lives of people on low incomes, and the way in which savings and the holding of assets can promote engagement in the economy and in society (Sherraden, 1991; Bynner and Paxton, 2001).

It was argued there was often a fine line between the provision of financial services and the impact of those services on the social and economic fabric of society

The provision of affordable financial services in low-income communities in itself, therefore, contributes to building and cementing the fabric of society. Credit unions, however, go one step further. They do not provide services to customers, they serve their members. They bring people into membership of a democratic and co-operative institution that endeavours to communicate the social and ethical principles of mutual self-help, community cohesion and of 'people helping people'. All Growth Fund credit union managers spoke of the challenge of ensuring that people who had come to the credit union for an instant loan were incorporated fully into the organisation as participating members. Becoming a member of a credit union is a step towards the development of links and connectedness within the community, and can contribute significantly to a pathway to social inclusion.

Volunteers and the building of social capital

Credit unions take a further step in building social cohesion within communities. They seek out members and other interested individuals to take an active role in the organisation as volunteers, whether as directors, committee members, specialist advisors, operational staff, champions or activists. Engaging people as volunteers builds trust, civic spirit, goodwill, reciprocity, mutuality, shared commitment, solidarity and co-operation, all of which are the elements of what is understood as social capital (Putnam, 2000; Ridley-Duff and Bull, 2011). They are essentially the characteristics of the 'Big Society',³⁵ in which relationships are built on trust and mutual endeavour, rather than solely on the pursuit of economic advantage.

For most of the London credit union managers interviewed, engaging committed and competent volunteers is central to effective credit union organisation, member engagement and outreach into the community. However, the ways in which individual credit unions seek to

³⁵ "We want to give citizens, communities and local government the power and information they need to come together, solve the problems they face and build the Britain they want. We want society – the families, networks, neighbourhoods and communities that form the fabric of so much of our everyday lives – to be bigger and stronger than ever before". Building the Big Society, 10 Downing Street website. 2 April-2011

engage volunteers vary considerably. For some credit unions, volunteer issues mainly concern governance and technical support, for others they relate more to operations and service delivery. Also variable is the relative success of credit unions in recruiting, supporting and retaining volunteers in response to the needs of their organisation. Some credit unions are able to recruit large numbers of volunteers, whilst others reported finding volunteer recruitment and retention to be very difficult.

For some credit unions, dependence on volunteers is high, not just in regard to governance and technical specialist support but for day-to-day management and operations. Greenwich Credit Union, for example, has over 40 volunteers and would be unable to deliver an effective service without them. In other credit unions, such as London Mutual Credit Union, that have the resources to employ professional managers and staff teams, dependence on volunteers for operational management and service delivery is no longer seen as necessary. However, in varying ways and in relation to differing responsibilities, all credit unions rely for their success on volunteer engagement and support.

Volunteer boards of directors

The importance of the engagement of skilled volunteer directors has been discussed in the previous section (Section 2.4). Among the group of credit unions in the study, there were many examples of skilled and competent volunteers serving on boards of directors. In some, however, finding sufficient skilled, committed people to serve as on credit union boards was problematic.

There is an ongoing need to recruit directors who can contribute expertise and leadership and who are able to think strategically about the future of credit unions in London. Where boards are strong, there is a focus on skills audits and succession planning to ensure board continuity and a strategic approach to board development.

Volunteer specialists and domain experts

Credit unions spoke about the pro-bono voluntary assistance they often received from specialists and domain experts willing to support the development of the credit union.

There were examples of local authorities, social housing providers and banks offering business and technical advice for particular projects and developments. Such task-oriented and often time-limited volunteer support can be essential to assisting credit unions achieve specific goals and targets.

Volunteer operational staff

Most London credit unions started as traditional small collectives staffed entirely by volunteers. However, as they developed, they employed managers and paid staff to take on responsibility for operational tasks. This was to ensure organisational efficiency and to deliver a more consistent quality of service to the membership. Undoubtedly, as credit unions expand and develop as financial institutions, credit union dependence on employed professional staff increases.

A number of credit unions in London have already moved away entirely from involving volunteers in operations and service delivery. However, many others still continue to depend on volunteer staff for the day-to-day running of the service. With appropriate support and training, these credit unions are confident that volunteers are able to deliver an efficient service that is appreciated by members and that assists credit unions to remain close to the communities they aim to serve. Volunteering engages local people and often involves people who would not normally be involved in any other form of community or social enterprise.

Some of the credit unions that depend on volunteers are engaging younger and more skilled volunteers who receive on-the-job training and experience that will benefit them in longer term job search and career development. Through volunteering, credit unions are able therefore to offer young people experience and add value in terms of their long-term employability.

There is an ongoing need to recruit directors who can contribute expertise and leadership and who are able to think strategically about the future of credit unions in London

Haringey, Islington, and City Credit Union also offers internships to students from the United States. These skilled young people volunteer in the credit union for a period of several months on specific project development and, in return, gain the experience of working in a community financial co-operative in the UK.

It should not be thought though that volunteering is just for people who can go on into productive employment. Retired people often have particular skills and talents to offer and their involvement can contribute significantly to local social cohesion and stability.

In the longer-term, however, as credit unions strengthen their systems and procedures, it was accepted by most credit union managers that the necessity to engage professional paid staff to manage the day-to-day operations will increase. Nevertheless, this did not mean that volunteers will no longer be central to the organisation and service to delivery, but it will mean their roles and responsibilities will change and re-focus on those areas where their skills, expertise and connections can be best used.

Volunteer credit union champions and activists

One important area where volunteers are essential to the development of the credit union is in spreading the word about the work of the credit union. Research has demonstrated that most people, particularly those on low incomes, learn about the credit union from others or through local social networks (Jones and Barnes 2005). In workplaces too, what often influences members to join is the knowledge and information about the credit union they received directly from other members, workmates and colleagues. What influences them to join and promote the credit union is the confidence and trust that friends, family and colleagues show in the organisation. Credit unions still need to recruit volunteers, as champions and activists, who can promote a local credit union identity and communicate to others the value of credit union membership. It is often through word of mouth that people on low incomes are attracted into credit union membership.

Volunteer co-ordination, training and support

It was argued by partner representatives in research seminars that credit unions that offered opportunities for volunteer involvement and training, including accepting placements from colleges and other institutions, were more likely to be attractive to social housing providers than those that did not. For by so doing, credit unions were contributing to the local economy and also to the social cohesion of communities. This commitment to the local community, it was stressed, should be part of the vision of credit unions, as it adds to their attractiveness as financial institutions for tenants and others on lower and more moderate incomes.

Indeed, as has been maintained already in this section, credit unions do share this vision of promoting community cohesion, and endeavour to offer a range of volunteering opportunities that are supported by appropriate training and supervision. The move to a more formal support system for volunteers has resulted in a number of credit unions employing volunteer co-ordinators, with others seeking external funding to do so. The employment of a volunteer co-ordinator goes hand-in-hand with the establishment of volunteer policies, in which the responsibilities and obligations of the credit union and volunteer are detailed in relation to agreements, expectations, standards and rewards.

The future of volunteering in London credit unions

Volunteering is integral to the functioning of London credit unions but the roles undertaken by volunteers will undoubtedly change over time. At board level, volunteer directors are facing the increasing demands of governing a modern financial institution. They need increasingly to be skilled and competent in decision-making and strategic thinking, and are often expected to have specific professional expertise to offer. Volunteers are now often sought for their specialist and technical knowledge, rather than for their functioning as unpaid operational staff.

However, in many credit unions in London, engaging volunteers as front-line staff still remains important and critical to success. In these credit unions, they retain a key role in

Volunteering is integral to the functioning of London credit unions but the roles undertaken by volunteers will undoubtedly change over time

enabling credit unions to function and to reach out into communities. If, as expected, paid staff members increasingly take on these operational responsibilities, volunteers will still retain an important role in ensuring credit unions remain close to communities and responsive to their financial needs.

It was stressed in research sessions that credit union volunteering links closely to current government ideas on strengthening the 'Big Society'. It was argued that credit unions need to highlight and stress the variety and range of volunteering opportunities they offer as community based organisations and demonstrate clearly the role they play in generating and building social capital in neighbourhoods and local communities.

2.6 Expanding service delivery

This study has indicated that expanding access to affordable financial services calls for a radical change in multiple aspects of credit union policy, practice and organisational structure, all of which have to be addressed simultaneously

The central question to be addressed in this study was how credit union products and services could be expanded throughout London and made accessible to large numbers of people, particularly those in low-income communities where access to affordable credit and other financial services is absent. At the start of the research, there was a temptation to look for some particular group of measures that could be implemented quickly, which would open up access to affordable financial services at a stroke to those that needed them. However, the reality of expanding access to credit union services is much more complex.

This study has indicated that expanding access to affordable financial services calls for a radical change in multiple aspects of credit union policy, practice and organisational structure, all of which have to be addressed simultaneously. It involves development in business and market-oriented practices, strengthening financial discipline and structure, as well as directors and staff rethinking governance, leadership and management in their totality. This is in line with the experience of the World Council of Credit Unions, whose credit union strengthening programmes all testify to the challenge of reforming credit unions simultaneously in all aspects of their organisation (Branch and Cifuentes 2001). It has also been the experience of ABCUL on prior development projects in the UK (Jones 2005).

In specific reference to expanding service delivery, four key areas emerged from the research discussions. These were:

- Product diversification
- Expanding the credit union branch network
- The move to electronic delivery channels
- The development of payroll deduction facilities

Product diversification

Credit union managers were conscious of the fact that the expansion of credit unions depends on developing products and services that people want. Several argued that credit unions have re-thought their position in the market and understand the importance of introducing a wider range of more commercially attractive products and services. Following Richardson (2000a), product diversification is now accepted as a key doctrine of credit union success and fundamental to serving the varying needs of the membership. This point was reiterated in a report on the modernisation of Irish credit unions, the primary recommendation of which was that credit unions should provide a full range of updated savings and lending products that meet the needs of modern consumers:

"To truly excel in their core business, credit unions need to begin by offering a much broader array of modern savings and lending products. The traditional share account is manifestly outdated as the primary vehicle for member savings. It is limited by law to paying dividends only once a year, and then only in arrears after the annual accounts are closed. Likewise, members need more borrowing alternatives than the traditional closed-end instalment loan that has been their staple from the beginning." (CUDA 2006).

This has led some credit unions to develop a range of savings accounts³⁶, to adopt greater flexibility in credit administration, to offer multiple loan products (including revolving credit accounts), to introduce the Credit Union Current Account, and to offer a range of insurance products. Of course, all Growth Fund credit unions were necessarily involved in diversification, through offering an instant loan product to meet the specific needs of financially excluded individuals. Some credit unions are also considering introducing pre-paid debit cards and offering interest-bearing savings accounts when this becomes possible under the new legislation (HMT 2009).

At least one credit union, among the 15 interviewed, was also interested in moving into being able to offer mortgages, which it saw as offering a new level of partnership working with social housing providers, most of which offer shared ownership schemes. It was noted by social housing providers that there are examples of people taking out shared ownership mortgages with sub-prime lenders. This, they felt, was an area credit unions could combat effectively.

It was stressed by participant credit union managers, however, that it is important to recognise that the low-income or financially excluded market has its own needs and requirements that are distinct from the mainstream. This needs to be stressed as it impacts directly on how products and services are structured and delivered. This was particularly in evidence with the introduction of the Credit Union Current Account, which could not be just another basic bank account as offered by multiple high-street banks, but rather a product designed specifically with the needs of people on low incomes in mind (cf. Jones 2008b).

However, at the same time as some credit unions have moved to diversify the range of products on offer, others have retained a more traditional approach to the business and remain limited to offering one or two savings accounts and a standard closed-end instalment loan product that links the amount that can be borrowed to a multiple of savings held. Some credit unions that offer Growth Fund instant loans have also retained the link between loans and savings' balances for their core business. As the Irish report argued (CUDA 2006), this may give the credit union a sense of security in managing risk, but it also limits the flexibility and attractiveness of loan products within the wider financial market place.

Despite significant advances in some credit unions, therefore, it would be fair to say that product development and diversification in London has been slow. This is undoubtedly as a result of credit unions sticking to what they know best but it is also the result of a lack of development resources. The lack of resources certainly impacted on the introduction of the credit union current account; many credit unions that acknowledged its importance said that development costs were prohibitive. Lack of product development may also be the result of a lack of experience and confidence in product development in an increasingly competitive market place. Each credit union having to develop its own products and services is not only expensive but engenders hesitancy in moving forward. In some cases this hesitancy resulted in some credit union managers claiming that they had no interest in offering a current account and that they preferred to retain the credit union as primarily a savings and loans organisation.

These variations in approach and resource capacity have resulted in credit unions in London offering products and services that are often very dissimilar from one another. For partner organisations in interview, this was a diversity that had more to do with inconsistency than a planned response to the varying needs of members in a particular locality. It led social housing providers, for example, to claim that there was no single clear message that they could put out to their tenants about the benefits of joining and using a credit union. There was inconsistency in the range of products available, but also in their terms and conditions, and methods of delivery, which led credit unions to being so different that their promotion was seen as problematic. Perhaps some would justify this diversity or inconsistency on the grounds of autonomy, but it prevented the effective and collective marketing of credit unions throughout the capital.

It is worth noting that there were mostly limited insurance products on offer, and the few credit unions that offered money transfer did not regard it as an important part of the business.

Despite significant advances in some credit unions, therefore, it would be fair to say that product development and diversification in London has been slow

³⁶ All credit unions will be able to offer interest bearing savings accounts with the new legislation due later in 2011 (HMT 2009). At the moment, Version 1 credit unions are limited to paying dividends on savings only once a year, and then only in arrears after the annual accounts are closed.

Expanding the credit union branch network

Traditionally, the expansion of credit union services has been linked to the development of branch offices and collection points (service points) throughout an area or neighbourhood. The benefits of credit union membership have been seen as best communicated through word of mouth; and the physical presence of a branch or service point in a community has been regarded as highly important. For it enables the delivery of a local, person-centred face-to-face service, which research has shown is attractive to people on low incomes or who are unfamiliar with or excluded from mainstream financial services (Jones 2001, Jones and Barnes, 2005). When a group of London Mutual Credit Union members in Bermondsey were asked what they sought most in the new current account, they said that the most important thing for them was to have somebody to speak to (Jones 2008b). It is this human touch that branches and collection points can offer.

Credit union managers also recognised the role of branches and collection points in building links and in strengthening social networks among the membership and the communities within which they live. Through branches and collection points, credit unions create patterns of connectivity, which builds social capital on which such concepts as the Big Society are founded. Credit union branches and service points act, following Rowson et al. (2010), as community hubs through which community resilience and empowerment is engendered and strengthened. Importantly, they are able to reach out to the most marginalised and disempowered of people who would never cross the threshold of a bank or mainstream financial provider. For the excluded, financial inclusion through a credit union can be an important step on a pathway to social inclusion.

Participants recognised the importance of branches, but these were expensive to maintain and to staff within a low-cost credit business model

The issue of branches was a keenly debated subject among credit union managers and partner participants. The overriding issue was that of issue of cost. Participants recognised the importance of branches, particularly in relation to establishing trust and confidence in the credit union and in reaching out to the excluded, but these were expensive to maintain and to staff within a low-cost credit business model. There was a general acceptance that branches could be counter-productive if they were outdated, shabby and cramped. But the cost of modernised, well-located premises in London was particularly high. Some credit unions, with external grant funding, have opened modernised and attractive high street premises. But, with declining grant support, several were now faced with having to meet the high operating costs out of earned income. From discussions with several of these credit unions, it was estimated that a modern branch office can cost in the region of £60k per annum in London to operate and to staff.

However, this cost has to be set in context of the overall costs of expanding access to credit union services. Two of the credit unions interviewed had recently expanded to provide a service in the adjoining borough; Lewisham Plus Credit Union and London Mutual Credit Union have expanded to Bromley and Lambeth. Even if annual costs of branch locations were around £60K in each borough, this was less than the estimated £500k required over a 4-5 year period required to create a new credit union³⁷.

Of course, collection or service points are cheaper to operate as they usually involve the credit union providing an access point in the premises of another organisation. But they can still be expensive to operate if the credit union is using paid employees to staff the facility.

Clearly, partner organisations and agencies have an important role to play in assisting credit unions to open branches and to staff collection points in the community. London Mutual Credit Union, for example, was assisted in opening its new branch in Brixton by Lambeth Council and a local charity and, with the increasing closure of bank branches, banks may see their way to assisting credit unions to open in vacated premises.

A range of agencies have assisted credit unions to open collection points in their premises, including libraries, community centres, Sure Start centres, social housing offices, among other locations. Properly managed, with external support, collection points can boost direct delivery channels within communities without all the costs of a full branch structure. There

³⁷This is based on ABCUL calculations to establish a credit union with a small staff team in high-street premises in London.

was a strong feeling on the part of some participants that credit unions and partner agencies should investigate further how credit unions could increase their physical presence within communities to maximise at economic cost such direct delivery channels beyond branches.

Even though there was a strong appreciation of the value of branches and collection points, there was also realism in research discussions that it would be neither economic nor feasible to expand access to credit union services throughout London through branches and collection points alone. For one thing, there was some anecdotal evidence from managers that credit union membership tended to be highest in the immediate vicinity of a branch or collection point. It would be just impossible to expand credit union membership throughout the capital entirely through vicinity to a branch office.

To expand access substantially, it was agreed that access through a branch or collection point needed to be complemented by modernised electronic communication and delivery channels. This would open up membership to people for whom the use of a branch was difficult, inconvenient or even unattractive. The importance of a move to more electronic means of service delivery was high on the agenda of most credit union managers, who no longer saw access to services delivered solely and directly through branch offices.

In fact, to reduce costs, a few credit unions have moved away from a branch and collection point structure and high street presence altogether, and now offer financial services entirely over the phone, through the mail and by electronic means. For most partner organisations and most credit union managers, however, this was seen as a step too far. In the social housing research seminar, some of the social housing managers strongly argued the importance of face-to-face delivery channels for their tenants. Not only did this offer them personal support, conversations with face-to-face staff enabled people to grow in financial awareness and capability. They stressed that credit unions that had entirely moved to electronic channels were less attractive to the housing providers in the group.

Overall, however, there was among credit unions a move away from the need to introduce branches or collection points in each and every location. Given the costs and the resources involved, the branch and collection point model of expansion was not regarded as supportive of long-term financial sustainability, if it were not balanced by a greater focus on electronic means of product and service delivery.

The move to electronic delivery channels

The importance for many of the credit union managers interviewed of introducing electronic delivery channels related to the need to drive down costs, and to improve the quality of service to members and, importantly, to combat the digital exclusion of many people within low-income communities. One participating credit union had around 2,000 members paying their welfare benefits into the credit union, with the only option of withdrawing cash over the counter. Not only was this high cost in staff time and in charges for cash deliveries, it was inconvenient for members. It could also be seen as reinforcing financial exclusion as the members queuing for cash were not receiving the option of a service that most people expect from a modern financial institution. The same could be said in regard to making deposits or loan repayments in cash in credit unions. Not only was this costly to the credit union, it could be inconvenient for members. There were other drawbacks too. Cash repayments on loans, for example, can easily be missed and difficulties arise if members fall into arrears. Missed payments can impact on a member's credit record.

These considerations did not mean that the importance of face-to-face service delivery for many members on low incomes was not recognised. The value of a personal, face-to-face service was fully accepted. However of equal importance for credit unions was combating digital exclusion. In the 'Information Age', it is difficult to see how anyone can be fully integrated and socially included within society without electronic access to financial services. Without such access people have to queue in line for cash payments and withdrawals, are denied access to internet shopping and the many benefits that accrue from electronic cash transmission services. Digital inclusion in modern times can be an important aspect of social inclusion. As one woman in Southwark remarked, when asked what the highpoint was for her of having a debit card for the first time, accessed through the credit union:

The importance of a move to more electronic means of service delivery was high on the agenda of most credit union managers

"I like the idea that I can phone the local kebab shop with my card, when you call up, they deliver, and they will take your card." (Quoted in Jones 2008 b).

Electronic solutions considered by credit unions include mechanisms for electronic deposits (direct welfare benefit deposits from DWP, standing orders, direct debits, payroll deductions, and Pay Point cards) and disbursements by BACS transfer, via the Credit Union Current Account or on pre-payment debit cards. Of course, some of these mechanisms are in place in some credit unions, but are inexistent or underdeveloped in others. The lack of the Credit Union Current Account was seen as problematic in a number of credit unions, but remained unaffordable for most. For credit unions without a current account, the roll-out of pre-paid debit cards offered members an easier way to access cash; the introduction of a credit union specific product through ABCUL was noted as a significant step forward.

The move to electronic delivery channels concerned not just deposits and disbursements. Communications through internet banking, online applications, emails, and SMS text messaging were encouraged in some credit unions and desired in most others. It was noted, for example, that the introduction of SMS balance updates could assist in giving low-income members greater control over their finances. Telephone communication, essential for many members, was however often problematic, as there were often insufficient staff members in credit unions to answer the volume of incoming calls. A number of credit unions considered the creation of a credit union call centre to be of high importance.

In the move to electronic delivery channels, developments are however undertaken individually by each credit union and few credit unions have the resources to implement major changes alone. Some credit unions, for example, have been able to pioneer new advances in internet and SMS technology, but these are few and not shared by credit unions across London. There are undoubtedly opportunities for more collaborative approaches to the introduction of technology, and for the investment and technical support of Government, the banks or other external agencies.

In Section 2.8, the possibility of a new and radical approach to the introduction of electronic service delivery is envisioned and discussed. ABCUL's development of a central services organisation containing a core electronic banking platform has the potential of offering credit unions a major collaborative technological advance. As discussed in this later section, this electronic hub could enable credit unions them to introduce the electronic delivery channels they seek and need, including internet access, SMS messaging, and even a common call centre. It will also open up the possibility of the delivery of credit union services through the Post Office Counters network, an advance which would open up access to credit union services significantly.

A key strategic goal of all credit unions interviewed was to maximise membership through electronic payroll deduction

The development of payroll deduction facilities

A key strategic goal of all credit unions interviewed was to maximise membership through electronic payroll deduction. Key target employee markets include local authorities, government departments, hospital NHS trusts and private companies. Many members on payroll deduction are on low incomes and payroll deduction is an important selling point to encourage low-income families to save and to borrow at affordable rates.

Some credit unions find it difficult to encourage local authorities and Government offices to start payroll deduction facilities. In some places, e.g. in Camden, it was claimed by the local authority legal service that there are legal reasons why payroll deduction cannot be agreed. This is a major block to development. Government and local authorities could do much to promote the credit union sector by supporting payroll deduction for employees in all local authorities and Government departments.

Expanding consumer demand for credit union services

A common theme running through research interviews was that much has yet to be done to build the identity and image of credit unions and to market their products and services more widely in London. Getting the message across about the potential and benefits of credit union membership remains both an opportunity and a challenge.

Increasing consumer demand for credit union membership depends on the quality of the products and services on offer, on access to them and on the efficiency of service delivery. The development of modern electronic delivery channels is central to success in attracting a wider, large and more diverse membership into credit unions. This is true for those both on low and on moderate incomes. In fact, it is difficult to see how large numbers of Londoners will be attracted into credit union membership without modern telephone and internet services, efficient money deposit and disbursement services and a much wider range of accessible products and services.

2.7 The strength of working in partnership

Throughout London, credit unions are working in partnership with statutory, voluntary and community organisations. This assists in community outreach and enables them to reach particular target groups; and it often strengthens credit union capacity to deliver appropriate and affordable financial services. London credit unions are regularly working closely with local authorities, social housing providers, money and debt advice agencies, Sure Start centres, Job Centre Plus, libraries, the Consumer Finance and Education Body, employment and training agencies, schools, tenants and residents associations, community centres and local churches. Of course, each individual credit union has its own arrangements, and not all in the study worked with a full range of possible partners. However, all understood the strength that partnership working brought to expanding access to financial services. The two most prevalent partners were local authorities and social housing providers.

There was more of an expectation that credit unions would not be just the recipients of support but rather would be active participants in mutually-beneficial initiatives and programmes

In research interviews, credit union managers and partner participants argued that a change had taken place in the approach to partnership working. In the past, partners were often supporters of fledgling credit unions, which they assisted with premises, grants and access to services in order to help them grow as viable community-based organisations. This was particularly true of local authorities, which, by the end of the 1990s were playing a lead role in London and elsewhere in supporting the emerging credit union sector (Jones 1999, LGA 2001). As noted in a previous chapter, in the 1980s and 1990s, the Greater London Council funded both ABCUL's regional organiser and local development workers to support small emerging credit unions.

Some local authorities and partner organisations continue to support credit unions in this way, but now it was evident, both from credit unions and partners, that there was more of an expectation that credit unions would not be just the recipients of support but rather would be active participants in mutually-beneficial initiatives and programmes. Alongside this expectation, there has been a move towards more contractual arrangements between credit unions and partner organisations. Newham Credit Union, for example, offers savings accounts to looked-after children and to those leaving care, as part of a partnership initiative with the local authority.

The Financial Inclusion Growth Fund was similarly a contractual partnership arrangement between credit unions and the Department of Work and Pensions. It was not grant aid or financial support, as may have happened in the past, but the allocation of capital and a contractual revenue payment to credit unions to provide affordable credit to certain designated groups.

Working with local authorities

Credit unions are operating in 29 London boroughs and, in nearly every case, there is some level of engagement with the local authority. In over 20 boroughs, credit unions services are offered to local authority staff through the support of payroll deduction agreements. In boroughs where as yet no credit union operates, there is often a growing interest in credit union services. Sutton and Merton Councils have recently supported, for example, Croydon Credit Union³⁸ to open in both their boroughs. In Kensington and Chelsea, a credit union feasibility

³⁸ Now Croydon, Merton and Sutton Credit Union

study undertaken in 2009 identified the support that any new credit union venture would be given by the local authority (GRE 2009).

Tackling poverty in London

In interviews, local government staff were confident that many people in local government in London are committed to credit unions and are aware of good practice in the sector. Credit unions, together with other social lenders, are regarded as having the potential to collaborate with local authorities in fighting poverty and in building prosperous, vibrant and cohesive communities. Credit unions are considered as sharing a community of interest with local authorities, and are seen as part of the solution to social and local economic regeneration in the capital.

Worklessness

The community of interest between local authorities and credit unions is multi-faceted and multi-layered. Local authority work streams relating to child and family poverty, worklessness and over-indebtedness (particularly in low and moderate income households) have identified the priority importance of access to affordable financial services, to money and debt advice and to financial capability education. 39% of all children in the capital are living below the poverty line. Tackling child and family poverty, therefore, and promoting financial inclusion and capability are key priorities of many London councils. Tackling worklessness is central to the local agenda; and in Southwark's economic development strategy, the role of social lenders is related directly to tackling barriers to work. Access to an affordable loan can sometimes be a factor that supports transition into work and even makes it possible.

Personal indebtedness

Personal indebtedness is a major problem in London and local authorities are particularly concerned about its impact on the health and well-being of excluded and vulnerable people. A recent report by the London Health Forum (2010), for example, highlighted the link between health and debt and outlined the role London councils can play in facilitating access to debt advice. It is noteworthy that it was the poorer inner (Lambeth, Hackney, Southwark) and outer (Barking and Dagenham, Newham) London boroughs that ranked among the highest callers to the CCCS debt helpline in 2009³⁹. Credit unions are seen as offering a service that assists many people to manage their finances and avoid over-indebtedness.

Localism and the Big Society

Many London councils have identified access to affordable financial services, money and debt advice and financial education as key factors in the process of building stable and cohesive communities. One local authority officer noted, for example, how important the local credit union was in assisting tenants to achieve financial stability and avoid rent arrears. Here, access to credit union services was a concern of housing management. In another local authority, it was the concern of social services, as it was through the credit union, that looked-after young people were learning financial management and budgeting skills. It was to pull together these elements of local authority interest in access to affordable financial services, and in building links with credit unions and other social lenders, that London Councils engaged, with DWP support, a financial inclusion champion, whose role was to liaise with local authorities throughout London.

Credit unions fit with an agenda around widening access to financial services, but there is a broader dimension to local authority interest in credit unions. As self-help, voluntary and local co-operative institutions, credit unions have a significant role to play in promoting the Big Society and in putting "localism" into practice. Credit unions are founded on people voluntarily coming together to work collectively for the common good of the people who live in their locality, who work in the same industry or are part of the same association. As such, they exemplify a commitment to society now defined by the term Big Society:

³⁹ GLA Intelligence Update, DMAG Social Exclusion Team Update, 30-2010 December 2010

Credit unions, together with other social lenders, are regarded as having the potential to collaborate with local authorities in fighting poverty and in building prosperous, vibrant and cohesive communities

“The Big Society is what happens whenever people work together for the common good. It is about achieving our collective goals in ways that are more diverse, more local and more personal.” (HM Government, December 2010).

In interviews, local government officers recognised that credit unions contributed to the promotion of local engagement often through the mobilisation of volunteers, and of local democracy through a focus on common ownership and community responsibility. In the words of the Localism and Decentralisation Bill, credit unions *“empower communities to do things their way”* and diversify and embed financial services in communities rather than organise and manage them on a national or global scale. This approach also fits with Lambeth Council’s (2010) understanding of a co-operative council, which aims to incentivise citizens to take an active role in their community, and to work with mutual and co-operative organisations to tailor services to the needs of particular areas and communities.

Longer term outcomes

In one research seminar, local authority participants stressed that credit unions need to highlight that they are organisations with the ethos and the capacity to contribute to the development of the social and economic fabric of society. It was argued that granting a person a loan can often have wider social and economic impacts within society. It may be that loan keeps a family away from high-cost lenders and directly assists their financial stability, with benefits to family and children all around. Or maybe a loan enables a young entrepreneur to start a business, with long-term outcomes for job creation and stability in the community. There are often, it was claimed, multi-dimensional links between the provision of affordable financial services and the facilitation of personal and social development, and community engagement and social entrepreneurship.

The reality of inconsistencies in credit union organisational strength and capacity resulted in a wide diversity of engagement

Lack of ‘robust’ credit unions with which to engage

However, even though the potential of credit unions to make a significant contribution to society was recognised by local authority participants, the reality of inconsistencies in credit union organisational strength and capacity resulted in a wide diversity of engagement. As one local authority participant put it, *“Even though a lot are, there are just too many credit unions not fit for purpose. They are too small and under-capitalised”*. Where credit unions are strong, or display real entrepreneurial spirit, local authorities regard them as key partners and often have offered significant support; where they are weak and lacking in vision, some local authorities are less well disposed to supporting their development. Of course, having credit union champions within a council, whether they are elected members or senior officers, can often be the factor that stimulates engagement and support. However, where elected members and officers are sceptical, weakness in credit union operations can militate against any real advancement.

Developing London credit unions

It was stressed that local authorities need credit unions with which they can do business. Local authority officers considered that there were a range of important opportunities for credit unions in London but these depended on their building credibility and capacity throughout the capital. Local authority participants considered that credit unions would need to consider developing the will and the resources to build:

- Consistency in identity, in message and in brand image. They need to agree a common vision which outlines clearly their purpose and potential, and how they contribute to the social and economic fabric of society.
- Visibility in London by adopting a social marketing approach which focuses on social as well as economic goals. Credit unions should be clearly seen as furthering the public good. This means that the language used in marketing activities should not be seen as replicating the banks.
- Engagement of people with visionary leadership, management competence and discipline in business. They need to continue to strengthen their board of directors and to

recruit managers with higher level management skills. They need to focus on long-term continuity beyond any current dependence on individual personalities.

- Economies of scale and to rationalise the London credit union movement through mergers. However, they should do this without losing or compromising on their local identity. London is made up of a series of smaller communities and locality matters. Some local authority officers felt rebranding credit unions with London-wide names may not always be in their long-term interests as it could be seen to weaken a local sense of identity.
- Enhanced delivery channels, including upgrading information technology. They need to ensure a range of delivery channels to reach out to the diverse communities in London. This will be through a mix of live-or-work, employee and associational credit unions, and, with new legislation, credit unions operating with multiple common bond definitions.
- Greater quality standardisation in products and services across London. They need to be able to offer a dividend on savings and not expect people to deposit money at no cost to the credit union.
- A more economically diverse membership and to engage with both low and moderate income communities.
- Credit union services in outer London, where the unemployment rate has risen at twice the rate of inner London since 2007. Outer London boroughs, particularly in the East (Barking and Dagenham, Enfield, Greenwich and Waltham Forest), have been more severely affected by the recession (MacInnes et al. 2010).
- Recognition of credit unions and of Fair Finance as places where people go for financial advice. The financial education of members needs to be re-asserted as a priority, and there is potential for credit unions to take a greater role in assisting in money management.

Local authorities have a potentially supportive and enabling role in the development of credit unions and other social lenders

Local authority support

Local authority participants also considered the measures local authorities could take to assist credit unions to expand access to affordable financial services in London.

The following were some of the areas of actual and potential local authority support for credit unions and other social lenders upon which participants agreed:

- Local authorities have a potentially supportive and enabling role in the development of credit unions and other social lenders.
- Local authorities want credit unions to be an affordable mainstream service that is able to reach many more people in London, particularly those on low incomes and facing financial exclusion.
- Although current financial constraints mean that traditional grant aid for credit unions is reducing and, in many cases, being cut or terminated, local authorities can still work with credit unions to identify other private and voluntary-sector sources of funding. In Lambeth, for example, the local authority worked with the credit union to secure significant funding from a local charity, the Walcott Foundation, to support a merger aimed at service expansion.
- Local authorities can include credit unions in local strategic plans. In Southwark, the delivery plan targeting worklessness and unemployment links both with credit unions and advice agencies. In other boroughs, credit unions are included in strategies aimed at debt reduction.
- Local authorities can still sometimes offer support in kind to credit unions or assist to publicise their services. They can assist in obtaining premises and other resources, offer facilities in one-stop shops and include credit unions in local marketing and publicity campaigns. The local authority in Lambeth assisted London Mutual Credit Union, for example, to open a branch in a disused shop unit in Brixton. There are examples of local authorities including on a housing benefit claim form that housing benefit can be paid into a credit union.

- Local authorities can sometimes offer technical support and training in key areas of management and service delivery. There are many skills that are transferrable from a local authority to a credit union, and in many cases, credit unions need to significantly raise the management and organisational competence of staff. Participants considered that there may be more local authorities could do to assist in training and in technical support.
- Local authorities could do more in purchasing services from credit unions. There are already examples of credit unions delivering services for local authorities in the areas of social care and in housing management.
- In Newham Credit Union, as already noted above, the Council deposits money in a credit union account on behalf of looked-after children who are able to withdraw it, with certain restrictions, when they are 18. On leaving care, the young person is able to open their own credit union budget account to support their setting-up a new home. There is a programme of financial education that accompanies this scheme, aimed at assisting looked-after children to manage finances associated with a tenancy effectively.
- In Southwark, London Mutual Credit Union administered a Home Rescue Loan Scheme on behalf of the Council, which assisted people in difficulties with mortgage repayments with access to small loans.

There are a number of examples of credit unions focusing development work in particular localities on behalf of local authorities, often around providing services to council tenants. It is to be noted that local authorities are able to contract out to credit unions the delivery of services to financially excluded groups in a way that does not contravene the state aids legislation.

There are new opportunities for local authorities to use the credit union pre-paid debit card for a range of council purposes and in a way to respond to the direct payments and personalisation agenda.

- There are examples of local authorities in London providing capital for on-lending to credit unions in the form of subordinated loans which impact directly on capital adequacy. Islington and City Credit Union⁴⁰, for example, received a significant subordinated loan (£250,000k) from the Council. In addition, there are often large amounts of money held in trust by local authorities that could be placed in an interest-bearing account in credit unions.
- Local authorities can support, and advise on, the mergers (transfers of engagements) between credit unions. Lambeth Council, for example, with multi-party agreement, assisted in the transfer of Lambeth Savings and Credit Union, a struggling credit union, into London Mutual Credit Union in order to expand access to credit union services throughout the borough.
- Local authorities often offer credit union payroll deduction facilities to their staff members. In some local authorities, loan products have been specifically designed for local authority staff. In Newham, for example, there is an easy access council employee loan scheme which aims to offer staff members an alternative to payday lending. Staff members can gain instant access to a loan up to £2,500 unrelated to their savings balance, which is charged at 1.5% per month on a declining balance.

London Councils is running a campaign to ensure that all councils in London are fully aware of the legality of and of the staff benefits accrued from offering credit union services via payroll deduction.

A payroll deduction facility is one of the most significant strengthening mechanisms that local authorities can offer credit unions. In Greenwich Credit Union, for example, employee based members are about a third of the membership, but hold around two thirds of the savings and loans and, according to the manager, “are the backbone of the credit union”.

The above examples of how London local authorities can and do support credit unions arose from research discussions with a small number of local authority staff. However, they indicate the potential and opportunity of greater collaborative working between local authorities and credit unions in London.

⁴⁰ Now Haringey, Islington and City Credit Union Ltd.

Credit unions are organisations that can contribute to the Big Society, to the enhancement of local identity, to community engagement and to a new co-operative approach to service delivery

It was stressed that there needs to be good co-ordination between local and national government support. The fact that the DWP Growth Fund did not engage with local councils was seen by many in local government as a lost opportunity.

Credit unions that have the organisational capacity to deliver can offer local authorities an important co-operative and mutual solution to working collaboratively with local citizens in the fight against poverty, disadvantage and financial exclusion. Credit unions are organisations that can contribute to the Big Society, to the enhancement of local identity, to community engagement and to a new co-operative approach to service delivery. Of course, all this depends on credit unions strengthening as a viable, sustainable and co-ordinated movement in the capital.

Working with social landlords

Around 70% of the people who experience financial exclusion live in social housing (NHF 2008). In London, in the five-year period 2006–2010, over 80% of all Growth Fund loans were made to social housing tenants. As a result, assisting tenants to build financial capability and manage their finances, and to access affordable financial services, are priority objectives for many social landlords (SLs), including housing associations and local authorities. These objectives arise from a concern to improve the lives of tenants and the fabric of the communities within which they live, but also from an economic interest in reducing arrears, evictions and the incidence of void properties. Tenant financial stability, as research suggests (Randall et al. 2006), impacts also on the economic sustainability of the housing provider, with evident benefits all around.

Strengthening credit unions as stable institutions was regarded as the sine qua non of the expansion of credit union services in the capital

Pathways to financial stability

However, most SLs do not endeavour to fight tenant financial insecurity and exclusion alone, but rather in partnership with a range of organisations which include credit unions and CDFIs. As the SL managers interviewed in the study stated, credit unions are regarded by most SLs as institutions which can assist and support tenants to better manage their personal finances. In this endeavour, access to affordable credit is central, but so too is access to transaction accounts, savings accounts, insurance, financial education and money, debt and budgeting advice. For SL managers, credit unions are not solely providers of lower-cost credit, but rather institutions within which tenants can receive assistance and advice in regard to multiple financial needs and develop a pathway to financial stability and inclusion.

Practical support to social landlords

Lewisham Plus Credit Union is an example of a credit union that works closely with several SLs, and which has been able to identify a range of practical ways in which it supports social housing tenants (Carlisle 2006). These include, alongside the provision of affordable financial products and services, working with tenants to help reduce rent arrears, providing basic financial advice or referral to debt and money advice agencies. The overall aim of the credit union is to assist people to manage their finances more effectively.

For SLs, credit unions represent the kind of accessible and community-based financial institution that is able to respond effectively to the recommendations of the 2007 National Housing Federation research into social housing and the provision of affordable credit, which stressed that *“third sector lenders should extend their product offering beyond affordable credit to encompass the opening of bank accounts, [and] the provision of money advice”* (Alexander 2007)

SL managers stressed in discussions that there is strong SL support for working in partnership with credit unions in London. However, at the same time, they stated that they were challenges which, in some cases, worked against stronger working relationships.

Credit union strength and capacity

SL managers argued it was difficult to support credit unions that were financially or organisationally weak. In order for SLs to recommend credit union membership to tenants, it was essential that they were sound and secure financial institutions. This did not mean that only larger credit unions could be recommended to their tenants, as size did not always equate to

stability and strength. Strengthening credit unions as stable institutions was regarded as the sine qua non of the expansion of credit union services in the capital.

There was a general concern among SL managers that many credit unions were under-staffed, over-stretched and over-worked in the delivery of financial services to low-income groups. They argued that it was for this reason that SLs rarely entered into partnerships with credit unions that were entirely volunteer-run. It was felt that credit unions without the support of paid staff did not have the capacity to guarantee delivery on any significant scale

Diversity in credit union products and service delivery

Another difficult issue for SL managers was perceived inconsistencies in credit union products, services and delivery channels across London. Managers felt that this resulted in there being no single, clear message that could be communicated to all tenants about the benefits and value of credit union membership.

This wide diversity in product and service delivery led, it was argued, to a dilution of the credit union brand image and to a situation in which many people, SL staff included, were unsure about what credit unions could offer to the population at large across London.

The Credit Union Current Account

With reservations from some participants, most SL managers considered that the Credit Union Current Account offered a real opportunity to expand credit union services significantly among social housing tenants. It was argued that banks were not geared up to serve low-income customers, leaving many underserved and vulnerable to penalty charges often associated with using a basic bank account.

The Credit Union Current Account was seen as designed to prioritise the needs of low-income members and to offer them flexibility and understanding in managing their finances. It was agreed by all SL managers interviewed that the extension of access to the Credit Union Current Account throughout London was an important goal for credit unions to achieve, as it contributed to maximising tenant choice.

Access – face-to-face and electronic

For some SL managers, there was a significant difference between those credit unions that offered a face-to-face service in a branch and those that had migrated entirely to the telephone and other electronic delivery channels. There was a strong feeling that some element of a face-to-face service was needed to be preserved if low-income and vulnerable groups were to be served effectively.

However, it was recognised that widened access to affordable financial services could only be achieved if credit unions also put greater emphasis on the development of electronic means of product and service delivery. There was a call for credit unions to relate more closely to the IT digital inclusion agenda. The introduction on internet portals and access was seen as important long-term, even though currently many tenants lack internet access.

Credit union image and the challenge of refocusing the business

SL managers argued that London credit unions were still often negatively regarded in London as ‘poor person’s banks’, which often resulted in many low-income people not using their services. It was strongly felt that this negative image often lay behind the low take-up of membership among SL staff, many of whom are on low or moderate incomes themselves. It was recognised, however, that this image does not necessarily reflect reality, as there are many credit unions that serve an economically diverse membership.

It was stressed that there was a solution to this image problem. Credit unions need to widen their understanding of whom they serve and increasingly to target low to moderate income working people. Even though many credit unions have developed much expertise in the low-income market, diversifying the business was seen to be a high priority and essential for longer-term sustainable development. 70% of housing association tenants are on welfare benefits, but 30% are not and are in work. It is important that this group of tenants, often struggling on insecure incomes, are prioritised in marketing campaigns.

This wide diversity in product and service delivery led, it was argued, to a dilution of the credit union brand image

It was suggested that one image-changing business opportunity for credit unions that have the capacity and the required permissions would be to offer mortgages to people wishing to take up share ownership options with housing associations. SL managers noted that, if credit unions ventured into this business, housing associations would be very interested.

Credit unions, diversity and localism

Overall, SL managers were looking for greater consistency and standardisation of access, product quality and service delivery in any moves to widen access to credit union services throughout London. However, they were not looking for just one model of credit union organisation, or just one or two credit unions to serve the whole of London; rather, they wanted credit unions to prioritise diversity and localism in operations and service delivery.

Despite the inconvenience of dealing with multiple organisations, SL managers interviewed still preferred to deal with credit unions that have strong links with local communities and neighbourhoods. It was stressed that it is good practice for multiple-borough credit unions to brand their branches to reflect the local community. Space also needs to be retained for small, locally based credit unions to be able to operate, even if it is within a common bond overlapped by other larger credit unions.

The development of access to credit union services through post offices would be seen to be an important step forward. This would both improve the quality of service delivery to members and contribute to developing a local accessible presence in the community.

Credit unions and volunteering

The opportunity for tenants to volunteer in credit unions was seen by SL managers to be of high importance. If credit unions moved away entirely from engaging with volunteers on an operational level, this was seen as a major setback within the sector. Credit unions appeal to SLs because they deliver local financial services and, at the same time, contribute to community cohesion and the building of local social capital. Engaging volunteers can contribute significantly to the tackling worklessness agenda, or if retired, can enable people to contribute to the quality of life of the communities in which they lived.

Supporting credit unions – a mutually beneficial endeavour

23% of all London housing stock is social housing, rising to 50% within boroughs in East London. Half of all London social housing is in one quarter of the wards of the capital. These statistics alone demonstrate the importance of the role of SLs in widening access to affordable financial services in low-income communities. SL managers stressed that working with credit unions was seen as a mutually beneficial endeavour, through which SLs supported credit unions so that they in turn could support services delivery to tenants.

There are multiple examples of SLs in London working with credit unions. Notting Hill Housing Trust took a key role in the development of Hammersmith and Fulham Credit Union and has seconded staff to work in the organisation. It is the Octavia Foundation, founded by Octavia Housing, which is supporting the steering group considering the expansion of credit unions services to Kensington and Chelsea. SL managers were keen to stress that, where they are successful, partnerships with credit unions are built on trust and good personal relationships and are seen to have mutual benefits all around.

Credit unions, funding and resources

The need of credit unions for both capital and revenue funding was recognised. SL managers stated that SLs appreciate that they need to support credit unions and are open to investing financially in them. However, given the current financial climate, it is unlikely that any significant investment in the sector would be possible for at least the next 18 months. It was stressed that credit unions still need significant capital and revenue support from central government and/or from others. Without such support, credit unions will not attain their potential in London.

The practicality of investing in credit unions was raised as an issue. Some SL managers had previous experience of wanting to make subordinated loans to credit unions, but had found the process to be too complicated. They concluded that it was much easier to donate funds

SL managers interviewed still preferred to deal with credit unions that have strong links with local communities and neighbourhoods

as a gift to credit unions rather than make a loan. This was perceived as a disincentive to SL investment in credit unions. Once new legislation is enacted, there needs to be clear information for SLs on how they can deposit and loan funds to credit unions.

It was noted by managers however that SLs do give in-kind support to credit unions. Staff time is put into supporting credit unions, as well as office, marketing, promotional and branch facility resources. There is always also the possibility of SL staff volunteering in credit unions, as this was one way of transferring much needed skills into credit unions. However, this depends on local circumstances and the nature of the placements on offer.

Evaluating SL investment in and support for credit unions

An issue raised by managers was the evaluation of the impact of SL investment in credit unions. They argued that it is important that credit unions record and monitor outputs arising directly from SL financial, material or in-kind investment, and they need to put in place mechanisms to record basic data on tenants served. This has proved difficult in the past, as credit unions have not asked or recorded the housing tenure of members.

One example of the monitoring of SL investment comes from Lewisham Plus Credit Union where tenure, loans made and saving accrued is recorded for housing association purposes. This has revealed that 60% of tenant members in Lewisham save in the credit union. This was regarded as positive step forward in assisting tenants to manage their finances and makes steps towards financial stability through accessing credit union services.

Working with the financial inclusion champions

There is always also the possibility of SL staff volunteering in credit unions, as this was one way of transferring much needed skills into credit unions

The Financial Inclusion Champions initiative, led by the Department of Work and Pensions, was developed as part of the Labour Government's financial inclusion strategy. Its aim was to build and co-ordinate partnerships with local authorities, social landlords and financial inclusion intermediaries, including credit unions, in order to promote financial Inclusion in low-income communities. The initiative ran from 2009 to 2011, a period coterminous with this research study.

In London, a team of five financial inclusion champions worked closely with credit unions in order to stimulate demand for and expand access to credit union services in underserved low-income areas. Signoretta, et al. (2011), in their evaluation of the initiative, pointed to its success in engaging with and strengthening networks of partners and providers. Some examples of financial inclusion champions stimulating partnership working included:

- Croydon Savers Credit Union⁴¹ – The South London Champion worked with Croydon Savers to facilitate local partnerships and the FSA application to extend the credit union into Sutton and Merton. DWP funding supported the credit union to develop credit union services in financially excluded wards of Fieldway and Addington.
- Ealing Credit Union – The West London Champion worked closely with Credit Union Solutions, the back office company that administers the credit union's operations, to establish a Financial Inclusion Forum in Hillingdon in order to raise awareness of credit union services in West London.
- Liberty Credit Union – The East London Champion was proactive in supporting Liberty Credit Union and the London Borough of Barking and Dagenham to establish credit union services in Barking and Dagenham through the expansion of Liberty's Credit Union's common bond to cover the borough.

The Financial Inclusion Champions initiative was an example of how Central Government or external agencies in general can support credit unions to expand their services into new areas and markets. After the termination of the initiative in March 2011, the strategic financial inclusion champion remained in post to support the development of London Money, a collaborative internet website for all credit unions, CDFIs and social lenders operating in the capital. This is a practical example of how credit unions are able to collaborate to expand services together.

⁴¹ Now Croydon, Merton and Sutton Credit Union Ltd.

2.8 Expansion, rationalisation and the challenge of collaboration

The credit union landscape in London is changing. Over recent years, credit unions have increasingly extended their common bonds to serve the entire borough within which they are located and, in some cases, to serve adjacent boroughs as well. There are now 16 borough-wide live-or-work credit unions⁴², nine of which also serve an additional adjacent borough. Croydon, Merton and Sutton Credit Union, now serves three London boroughs, as does Haringey, Islington & City Credit Union.

As some credit unions have expanded, others have disappeared. They have either transferred engagements (merged⁴³) into a stronger credit union or, in a few cases, have closed down altogether. Hackney Credit Union, for example, closed in 2010. The process of expansion, closure and merger has not been offset by emerging new credit unions, the last to open were in 2008. A rationalisation of London credit unions seems to be underway and there is every indication that this is a process set to continue.

Common bond expansion

Common bond expansion has been regarded by many credit unions as a key strategy in building the membership. Expanding a credit union's area of operation opens up new target markets and enables a credit union to reach out to people not served with credit union products and services, including new employee groups through payroll deduction facilities. This strategy of expansion is seen throughout London. Among the nine multi-borough credit unions are London Mutual Credit Union which now serves Lambeth as well as Southwark; Ealing Credit Union which also serves Brent; M for Money Credit Union which serves Hillingdon as well as Harrow, and London Community Credit Union which now serves both Hackney and Tower Hamlets.

Common bond expansions have resulted in credit unions now being open to anyone who lives or works in 27 of the 33 London boroughs. This rapid expansion of coverage is a real step forward on the way to ensuring that all Londoners can join a credit union. In a number of cases, common bond expansion, supported often by the capital investment of the Growth Fund or of other agencies, is resulting in significant membership growth (see Section 2.1). In other credit unions, expansion is so recent that its impact is not yet possible to measure.

However, one concern must be that in many of the credit unions that have expanded their common bonds, membership penetration remains low in the original common bond area. This means that credit unions are often not moving into new markets on the basis of already high membership penetration ratios. Expanding geographical coverage is therefore no real guarantee of significantly widening access to, and take-up of, credit union products and services in the new common bond area. Common bond expansion per se may remain just an exercise without the leadership, drive and organisational capacity to turn the opportunity offered by expansion into the reality of actual growth in members, savings and loans.

In interviews, concern was expressed by some credit union managers who had submitted common bond expansion applications to the FSA that these had been subject to delays. This had led to some frustration among managers, and a feeling that the FSA was putting unnecessary obstacles in the way of expansion and retaining a position of not generally agreeing to London credit unions serving more than one borough.

However, research interviews conducted with FSA staff revealed that any perceived delay was not due to any general limitation of credit union expansion in London, but, if anything, would have related to FSA concerns about the capacity of credit unions to serve new areas when existing areas remained significantly underserved. There was a detectable worry that some business plans submitted to support common bond expansion, were more to do with accessing new sources of external financial support rather than strategic responses to building the business. In fact, most credit union common bond expansions were supported by additional

⁴²This would be 17 with Wandsworth Credit Union, usually omitted due to its low membership. See Appendix II

⁴³In most cases of credit union merger, one or several credit unions transfer their engagements into a stronger, lead credit union. Mergers are technically possible but rare; most credit unions consolidating operations do so as a result of a transfer of engagements. References to mergers in this study are references to transfers of engagement.

However, one concern must be that in many of the credit unions that have expanded their common bonds, membership penetration remains low in the original common bond area

grant funding provided by local authorities, social housing providers or other agencies. This was normally provided to cover the costs of opening a new branch or serving new target markets within the new borough.

Without exception, the FSA agreed the common bond expansions of all the credit unions wishing to develop services in a new borough. But the concern remains that common bond expansion could be a liability rather than a strategic development opportunity if credit unions lack the organisational capacity and delivery channels to expand significantly within new markets. Credit unions already struggling to serve one borough effectively are not necessarily going to find the capacity to serve another easily, even if expansion is supported by additional external funds.

Ensuring the organisational capacity and strength to serve new and emerging target markets will become even more important with the possibilities of greater common bond expansion following forthcoming legislative and regulatory changes expected later in 2011. Credit unions will need to develop efficient and effective systems and procedures if they are to handle any further expansion of service delivery effectively.

Creating new credit unions

The last new credit unions to be opened in London were Camden Plus and Hammersmith and Fulham Credit Unions, both registered in 2008, and no examples of plans to create new credit unions emerged through this study.

There is an active credit union steering study group that is exploring ways to enable people who live or work in Kensington and Chelsea to access credit union services. With the support of social housing providers and the local authority, the group commissioned in 2009 a feasibility study into the development of credit union services for the borough. This study identified the need for access to affordable credit in large areas of disadvantage within Kensington and Chelsea, a borough normally associated with the better-off, but which has 22.3% of its wards classified among the top 20% most deprived in the country (GRE 2009).

The feasibility study argued that the development of a new credit union for Kensington and Chelsea would be time-consuming and resource intensive, and that it was unlikely that a new credit union could develop the organisational capacity or economies of scale to serve people in the borough effectively. The study recognised the increasingly competitive market within which credit unions operate and that any new venture would have to have the capacity to deliver quality products and services from the outset. The overriding conclusion was that development should “exclusively concentrate” on extending the geographical operations of an existing credit union in order to offer its services within Kensington and Chelsea.

This feasibility study highlighted the growing realisation within the credit union sector that the development of the operational infrastructure, systems and capacity to operate a quality credit union is increasingly demanding of physical and human resources. The delivery of efficient, modern financial services that appeal to an economically diverse membership not only requires high level governance and management skills, it requires significant investment.

The creation of credit unions in London in the past has led to a broad understanding of the set-up and running costs of a new credit union over the first four or five years of its operation (see Appendix III). Major costs are staff and premises; the latter being particularly high in London given property rental costs. It is estimated conservatively that approximately £400 – £500k investment is required over four to five years to establish a credit union in London, opening with two staff members in year one, rising to four staff members in year five (see Appendix III). It was this sort of consideration that led the Kensington and Chelsea feasibility study to conclude that seeking out an existing credit union to expand its services into the borough was preferable to the creation of a new institution from scratch.

One other credit union steering group was identified in the study, Kingston Savers which is endeavouring to bring credit union services into the borough of Kingston-upon-Thames. Again, the group was not aiming to create a new credit union, but rather to negotiate an extension of Croydon, Merton and Sutton Credit Union into the borough. The group is supported by Kingston Council which is already providing credit union payroll deduction facilities for Council employees who live in Croydon, Merton or Sutton.

Ensuring the organisational capacity and strength to serve new and emerging target markets will become even more important with the possibilities of greater common bond expansion

Credit union consolidation

Organisational, operational and financial demands have led a number of credit unions in London to transfer their engagements (merge) into a neighbouring, and often stronger, credit union. In 2005, for example, Greenwich Waterfront Credit Union transferred into Timeline Credit Union, the local council employees' credit union, to form what was to become Greenwich Credit Union. In more recent years, the pace of mergers has increased. In 2010, North West London Credit Union was formed when Watling and Graham Park Community Credit Union and Finchley Community Credit Union transferred their engagements into Barnet Council Employees Credit Union. In the same year, Lambeth Credit Union transferred into London Mutual Credit Union and, in 2011, Deptford and New Cross Credit Union transferred into Lewisham Plus Credit Union.

In general, transfers of engagements have been often triggered by organisational and financial difficulties within transferring credit unions and, as such, they do have the potential to weaken the receiving credit union. When, in 2001, the failed Camberwell Credit Union transferred into the then Southwark Credit Union (SCU) (now London Mutual), even with a significant level of external financial support to assist the transfer, SCU's level of general reserves diminished to 42% of its pre-transfer level. In 2002, SCU recorded a deficit for the first time in its history (Decker and Jones 2007), and it took strong financial management and discipline for SCU to rebuild its financial strength. It is often the case that such transfers require external financial support to overcome deficits on the balance sheet of the transferring credit union to ensure that the receiving credit union is not destabilised.

With some notable exceptions, very few credit unions have sufficient staff to develop a middle management structure and sometimes even to fill key roles and responsibilities

However, even though transfers of engagements can be challenging, credit union managers in interviews considered that, in general, they are a business opportunity and to the long-term advantage of credit unions in London. Transfers can be a positive option for smaller, struggling credit unions and for receiving credit unions, as they offer potential advantages that come from economies of scale and from the opening up of new markets and areas of operation. In the United States, research into mergers has demonstrated that they can be particularly beneficial to members from a service perspective (Fried et al, 1999). By merging into London Mutual Credit Union, for example, ex-Lambeth Credit Union members gained access to a much wider range of financial products and services, including access to the Credit Union Current Account and to affordable credit through the Financial Inclusion Growth Fund.

The consolidation of credit unions through transfers of engagements has been a feature of credit union development nationally in Britain over the last ten years. The aim has been to achieve economies of scale and to build organisational capacity to operate in an increasingly competitive marketplace. Most credit union managers in London considered that the process of consolidation was set to increase, with even some in largest credit unions questioning the viability of their own independent future.

The current credit union development model under strain

Despite significant organisational advances and membership growth in individual London credit unions, the increasing rationalisation of the sector suggests that credit unions in London are under strain. In fact, transfers and even common bond expansions are often indications of organisations struggling to ensure a continued efficient service to members. In the case of expansions, indications of strain arise particularly when linked new funding has to be used to maintain core credit union operations rather than to exploit new market opportunities.

As has been already explored in this report (see Section 2.3), many credit union managers in interviews described how credit unions were often understaffed, how existing staff were over-worked, and how difficult it was for them as managers to think strategically whilst being themselves immersed in day-to-day operations. With some notable exceptions, very few credit unions have sufficient staff to develop a middle management structure and sometimes even to fill key roles and responsibilities. This often leaves managers having to pick up routine responsibilities that, in a fully staffed organisation, would be picked up by others. Managers were not confident that things would improve, particularly with the forthcoming greater administrative requirements associated with the new regulatory regime and impending

changes to accounting requirements. Local government funding cuts which put resources to employ existing staff at risk only added to the sense of difficulty.

Many credit unions were under organisational strain but all were under financial strain. Managers explained the ongoing challenge of driving down operating costs and of generating sufficient income from lending to free themselves from dependency on external subsidies. Even the largest credit unions were not yet breaking even and still had to count on external financial support.

In many credit unions, as explored in Section 2.3, insufficient income generation was often a result of a low loan to asset ratio and high liquidity. These credit unions were not lending sufficiently to members to maximise a return on assets. The current recession is certainly a factor in this, but reticence and fear in lending, linked to inefficient systems and procedures, is undoubtedly making an impact on reduced loan portfolios.

If poor lending impacts on income generation, then bad debts and poor loan loss recovery impacts on expense ratios. As was noted in Section 2.3, the control of bad debts is variable across London credit unions, but in certain cases, bad debts and loan loss recovery were posing significant problems. Of course, the incidence of bad debt is often linked to poor credit assessment, but it is also related to inadequate credit control systems and procedures.

As credit unions endeavour to manage the organisational, operational and financial challenges they face, they do so within an increasingly competitive context. Organisations and individuals are looking to deal with modern and efficient credit unions that have systems and procedures in place to deliver quality products and services to members ((see Section 2.7). They are looking for standardisation of quality and a more professional and responsive service. For credit unions to offer such consistency in the quality of services across London, even greater organisational and financial demands will be made upon them. The current model of credit union development may be under too much strain to deliver the kind of consistent, comprehensive, and accessible credit union service across London that people seek.

If credit unions are to offer a London-wide professional, comprehensive service to a widely diverse population, it seems clear that there is a need for a radically new approach to organisation and service delivery

The challenge of collaboration

Despite advances in business acumen and approaches to financial discipline, the problem with the current model of credit union development is that it depends on each individual credit union independently developing its own management and operational systems. Every process and procedure has to be replicated in each credit union over and over again. Not only does this result in diversity in product quality and range, it is resource intensive and expensive. It has led to uneven access to credit union services, with some boroughs being served by strong, professional credit unions, others underserved by weaker credit unions and with yet other boroughs with no access to credit union services at all.

If credit unions are to offer a London-wide professional, comprehensive service to a widely diverse population, it seems clear that there is a need for a radically new approach to organisation and service delivery. Given experience so far, it seems unlikely that over thirty credit unions, each taking different strategic directions and all facing separate organisational and financial challenges, will ever be able to offer a coherent quality service consistently throughout the capital. Of course, there is, and will be, centres of excellence, but a London-wide service, equal and accessible to all, will be difficult if not impossible to achieve.

Until now, widening access to quality credit union services has mostly been seen in the expansion of stronger credit unions and the merger of weaker ones into them. Of course, sometimes an often dire situation means that there is little choice but to merge or to close a desperately struggling credit union. However, there is the possibility of continued expansion and merger developing a momentum of its own and being seen as the only solution to the strengthening of the sector. This is not a momentum that has yet taken hold in London, but in interviews, managers, even of larger credit unions, often spoke of the 'inevitability' of continued expansion and merger, resulting in a drastically reduced number of credit unions in the capital in the foreseeable future. This could have some real disadvantages in regard to loss of local identity and community engagement.

However, there is another solution, other than expansions and mergers, to enabling people to access quality services within strengthened credit unions. This solution is found in greater

credit union collaboration and in the development of a cohesive and comprehensive system of shared services.

Internationally, co-operative banks and credit unions have adopted various collaborative approaches to development. These vary greatly from country to country; from the national centralised federated systems of France, Austria and French-speaking Canada, to the more decentralized, voluntarily-integrated models of Australia, US, Spain, and English-speaking Canada. Using data drawn from WOCCU and the European Network of Co-operative Banks statistical reports, David Grace (2010), WOCCU's senior vice-president of association services, has been able to demonstrate the link between collaboration and credit union success. Using data from twelve countries, Grace had shown that the greater the degree of collaboration, the greater the degree of market share.

This focus on the importance of collaborative systems to successful development has also been argued by Fischer (2002, 2005). Following extensive research into the performance of financial co-operatives operating on a federated-network as opposed to an atomized-competitive network model, Fischer (2002) demonstrated that those operating on a federated-network (collaborative) model displayed either equal or superior performance to those operating on a more atomised model. In a later study, Desrochers and Fischer (2005) argued that integrated, collaborative models tended to reduce the volatility of efficiency and performance and to control costs more effectively. They maintained that research also showed that, despite the high costs of running hub-like organisations in collaborative systems, these systems still operated at lower costs than less integrated systems.

In interviews, most managers were open to considering more collaborative approaches to development if these would reduce costs and improve performance and service delivery. They argued that credit unions in London already collaborated through the London and South East Chapter and could cite increasing examples of mutual support happening between individual credit unions. Some also referred to Credit Union Solutions in West London, which undertakes the administrative and operational tasks for a group of small credit unions, as a form of collaboration.

However, when Grace and Fischer refer to collaboration and integrated systems, they are not speaking of the mutual help and support that takes place in Chapters and between individual credit unions, or of the outsourcing of administrative and operational tasks to a third party company such as Credit Union Solutions. They are speaking of a cohesive, networked and integrated system which enables certain operations to be standardised for a group of credit unions and which allows for large scale collaboration on routine back office activities. The aim is to enable credit unions collectively to gain economies of scale, to improve the efficiency and effectiveness of operations and service delivery, to enhance brand recognition and strategic marketing and, importantly, to enable smaller credit unions to offer the same level of service as larger institutions. George A. Hofheimer, Chief Research Officer, at the Filene Research Institute in the US, defines collaboration this way:

"Large-scale credit union collaboration" is defined as multiple credit unions cooperating to drive scale, efficiency, and performance in core back- and front-office activities." (Filene 2008)

The range of back office activities that are suitable for such a collaborative approach can vary. Michael (2007), in conducting research with credit union managers in the US, found that those of keenest interest to credit union managers there were compliance and internal audit, consumer lending and marketing, accounting and information technology, human resources, and facilities managing and planning. When the idea of greater collaboration was discussed with managers in this study, there was particular interest in greater collaborative approaches to technological innovation, credit administration and control, internal audit and a credit union call centre. However, this list was not presented as exhaustive, but it is interesting in that it includes both back office and front office services. Collaboration on a call centre would be a front office initiative that directly improves services for members, given the difficulty many credit unions have in staffing phone lines.

It is important to stress that collaboration and the development of integrated systems calls for a cultural shift in the way boards and managers think about credit union organisation and operations. As Richardson (2000) remarked in reference to credit unions previously adopt-

This solution is found in greater credit union collaboration and in the development of a cohesive and comprehensive system of shared services

ing a new business-oriented development model, including the use of the PEARLS financial monitoring system, “the long difficult process of changing the way people think is by far the most difficult aspect of modernisation”. The adoption of a collaborative approach demands an equal, if not greater, change to the credit union mind-set. As Grace (2010) argues, collaboration involves a primary focus on commonality rather than uniqueness; and on a radical increase in the role of operational excellence in the credit union culture. In fact, it is a major sea-change and restructuring in the way credit unions operate and do business.

However, internationally, the benefits of collaboration are tangible. It frees managers from many of the routine administrative tasks and enables them to concentrate on strategic development; something many managers in London said was very hard to do. Collaboration generates economies of scale, enables technical expertise to be shared across credit unions, enables a wider range of products and services for small as well as larger credit unions, and offers greater stability and security within the sector. It also, depending how it is organised, has the potential of offering a central credit union organisation with which partner organisations and other bodies can do business, the demand for which was clearly stated by local authorities and social housing providers (see Chapter 2.6).

Hofheimer (Filene 2008) describes the problem as he sees it in the US, and what he sees as the solution in the following terms:

“For me the problem is anaemic credit union growth and the sustainability of the industry. The solution is large-scale credit union collaboration. There is a raft of data, experience, and philosophical undertones supporting collaboration among credit unions. Most credit union executives agree that... the business model is broken... competition is fierce... [and] fewer consumers are joining credit unions...”

Collaboration involves a primary focus on commonality rather than uniqueness; and on a radical increase in the role of operational excellence in the credit union culture

In interviews, managers in London argued that there was already collaboration that could be achieved by credit unions themselves. It was argued that there could be shared approaches to human resources, including the sharing of current staff and the hiring of specialist staff, to the development of shared networking with social housing providers, and of common job descriptions and of shared marketing strategies. In regard to higher level collaboration, as described above, there was a general openness to the idea among managers and an appreciation of the benefits it could bring. However, this was tempered by uncertainties about what would be involved in practice and, importantly, on what the financial implications would be to create a collaborative system for credit unions in London.

Certainly cost is an issue. Development of a cohesive, collaborative system depends on sophisticated information technology, understood as an electronic central hub or central services platform through which back office services can be operated. Simply put, an electronic hub is the necessary kit that makes collaboration possible (Michael 2007). London managers were right to be concerned about cost, for such a central hub takes considerable financial investment (Filene 2008).

Harnessing technology – ABCUL’s proposed back office initiative

Throughout the world, collaboration is a response to a business need and must be based on a vision of mutual interest in driving down operational costs and improving products and services for members. The vision must come first, but to achieve that vision it is imperative to harness technology. An electronic hub is the sine qua non of any credit union collaborative system. This has led ABCUL to work with an external consultant to explore the development of a central services organisation containing a core electronic banking platform. This will enable extensive collaboration on core back office functions throughout the credit union sector, not just in London. It will assist the operation of loan, savings and transaction accounts, including internet access and SMS messaging, and enable the development of a range of collaborative services, including treasury management, and possibly general ledger accounting and internal audit.

The platform will facilitate the development of new credit union products and services, even for those credit unions that are not using the new platform, and is adaptable to support new functions as required, such as bill payment accounts and pre-paid debit cards. It will enable

a central customer service centre, open outside of office hours; and allow a link with the Post Office Horizon platform and other external platforms as they arise.

The link with the Post Office has major potential benefits for the credit union movement, as it will assist many more people to access their accounts, including both deposits and withdrawals, without the need to visit a credit union branch. This will be of particular benefit to people in low-income communities, who are often used to using the Post Office as a familiar service and may prefer not to access their accounts electronically or through the internet. It is envisaged that Post Office Ltd staff will be able to offer 80% of services available face-to-face in the credit union. ABCUL has pledged to work with Post Office Ltd to open up the 11,500 Post Office branches to credit union services. If this comes about, it will radically change the way members will be able to access credit union products and services in the future.

Given the experience of other co-operative financial institutions world-wide, there is also every reason to believe that collaboration via an electronic hub will assist in progressing greater professionalism and quality standards throughout the credit union movement. De facto, participating credit unions will be required to meet set operating and administrative standards. If credit unions wish, the platform will also allow for greater standardisation and consistency in product and service delivery. This is an important point. The core electronic banking platform is not in itself collaboration; it is the necessary technical condition for collaboration to happen, and the long term scope of this collaboration is the choice of participating credit unions. Greater consistency in products and services will also allow such developments as a central marketing facility, something often desired in the credit union movement but still not attained.

In interviews, as with the general issue of collaboration, credit union managers were generally positive about the ABCUL back office proposal, but there were uncertainties about how it would work in practice and how such a collaborative electronic hub would be governed. Collaboration with Post Office Ltd was also subject to a 'wait and see' approach. There was general support for access to this very significant delivery channel, but there were concerns about what it would involve, whether it would be affordable and whether it would be organised in a way to protect the credit union brand and identity.

During the period of the project, ABCUL estimated that investment of some £17 million would be needed to develop the central services organisation. Such investment is currently beyond the resources of the credit union movement alone, and would need the financial support of Government, banks or other investors.

However, in March 2011, the Minister for Employment announced that a new expansion and modernisation fund of up to £73 million was to replace the Financial Inclusion Growth Fund, which would end in March 2011. The new fund was to extend customer service to many more people on lower incomes, and to modernise delivery and customer support systems so that credit unions, and some CDFIs, could work towards financial sustainability. From April to September 2011, the DWP would work with partner organisations, including the Post Office, to explore ways of modernising financial institutions that are ready to expand.

This Government support for the credit union sector holds out the real possibility of creating a modern, collaborative central service organisation which would modernise and professionalise the sector, drive down individual credit union costs and ensure that credit union products and services are accessible to many more people throughout London and the country as a whole. It presents a major development opportunity for the credit union sector, so long as credit unions can learn to compromise and to delegate control of some back office functions in order to gain much greater benefits overall.

Collaboration on website development, credit administration and controlling bad debt

Grace (2010) argues that collaboration starts with small steps, or in other words, with short-term wins. The central services organisation, if it comes to fruition, will involve a major restructuring within the credit union sector, and will take several years to implement fully. However, the development of a collaborative culture can start immediately, as managers indi-

Given the experience of other co-operative financial institutions world-wide, there is also every reason to believe that collaboration via an electronic hub will assist in progressing greater professionalism and quality standards throughout the credit union movement

cated when they referred to increasing examples of inter-credit union co-operation taking place throughout London.

One example of a possible collaborative short term win that emerged through the period of the project is the development of a London Money website, co-ordinated through the Financial Inclusion Champions initiative. This website would enable people to access credit union and CDFI services and volunteering opportunities easily. It would begin to generate a common brand and image throughout the credit union and social lending sector and, if it materialises, would offer credit unions and CDFIs a readymade marketing tool.

Further possible examples of short-term win collaboration concern two major issues related to sustainable credit union development; these are credit administration and controlling bad debt. In this study, these two issues have surfaced as problematic for many credit unions in London. Many have lower than recommended loan to asset ratios, which impacts on their bottom line. In some credit unions, poor lending and insufficiently robust loan portfolios are creating serious financial issues. Bad debt and loan loss control is a separate but linked issue, which is causing problems in some credit unions.

During the period of this project, ABCUL has been working with a group of credit unions and Experian to develop an effective credit assessment process. The recommendation of this exploratory work is the development of an online loan application processing system, managed and operated by ABCUL and offered to all of its members, including those in London. The system would offer integrated access to Experian's credit bureau, automated decision-making using a bespoke scorecard, case management and supervisor functions. This collaborative system would not only result in more effective loan decision-making, it would improve member service with quicker turn-around time on applications.

ABCUL has also been working on a debt recovery project which relates to the credit assessment process but has a stand-alone importance. The aim is to create a cost-effective, centrally approved credit control process to help credit unions manage bad debt from the first stages of delinquency right through to litigation. London Mutual and Lewisham Plus credit unions have been involved in project development and the aim is to create an IT-based case analysis and management system.

Both the credit assessment process and the debt recovery project are examples of business-oriented collaboration in action, and both have the potential to improve income and cut expenditure in credit unions through better lending and reduced losses through bad debts. However, both require external financial support to implement, and a recommendation of this report will be that banks or supporting agencies consider assisting the development of the sector through investment in these measures.

Collaboration and the preservation of local control and identity

In discussions with credit union partners, it was clear that there was often a tension between seeking a credit union sector that offers standardisation, consistency and quality in product and service delivery; and that is also responsive and diverse at a local level. Credit union managers also spoke of the tension between developing a London-wide standard and consistent service, and retaining identity and embeddedness within local communities and social networks. Throughout the study, these two themes of the development of a London-wide accessible credit union service and support for a strong local community agenda have emerged constantly, without as yet a clear solution.

In trying to resolve this tension, some managers and partners spoke of limiting expansions and mergers so that common bonds could not extend to any more than two or three boroughs. Not only would this, it was argued, fit with the FSA requirements on the maximum size of a common bond, but it would allow credit unions to strengthen their identity with the local community. Some others argued, however, that there was inevitability to the continued expansion of strong credit unions and the merger and closure of small institutions, with London in the future perhaps being served by just a few larger credit unions.

However, there is another option to expansion and merger, and this is collaboration. Collaboration is designed precisely to give credit unions economies of scale, to strengthen

*Possible examples
of short-term win
collaboration concern
two major issues related
to sustainable credit
union development;
these are credit
administration and
controlling bad debt*

operations, to develop quality products and services, and to enable all credit unions to access more efficient and effective delivery channels. Collaboration supports larger credit unions insofar as it frees managers and staff from routine activities and enables them to concentrate on strategically building the business. But it also supports smaller credit unions, which will be enabled to offer the same range of quality services as their larger cousins.

Collaboration is not a hand-over of control of the management of the credit union to a third party. Overall responsibility for the credit union remains firmly with each individual credit union's directors and management. Collaboration is based on an agreement between credit unions that their collective future is best served by sharing back office and sometimes front office services, which, of course, means compromise and the delegation of the control of routine back office tasks to the central organisation. Collaboration enables credit unions to gain the benefits of economies of scale without compromising their commitment to localism and the community engagement.

The future is collaborative

Realistically, credit union expansions and mergers will continue. Some credit unions are still so small that meeting performance standards sufficiently to collaborate will be difficult, and some larger credit unions will still need to open up new and emerging markets in London.

However, there is a strong argument that the atomistic business model will not achieve the goal of enabling all Londoners to access quality credit union products and services. Apart from one or two examples, there is little evidence that the atomised model is attracting large numbers of Londoners into credit unions. World-wide, atomised systems seem to grow to a certain size and then stagnate.

Collaboration depends on credit unions building trust and confidence in a common, collective vision of the future

On the other hand, there appears to be a compelling business case for centralised back office services to credit unions and a collaborative approach to development. With the current potential support of Government, there is now a real opportunity for London credit unions, along with credit unions nationwide, to take a major leap forward into the future.

However, it is important to remember that the electronic banking platform, as developed by ABCUL and supported by Government, is not in itself collaboration, it is the facilitator of collaboration. Collaboration depends on credit unions building trust and confidence in a common, collective vision of the future. Collaboration is a massive cultural change in the way credit unions operate and do business, and requires collective investment, compromise and an immense amount of goodwill to make it happen. Barriers to collaboration will surface. Some credit unions will feel threatened by larger players, whilst others will be concerned about a loss of local identity and many conflicts will arise. Collaboration, however, means working through these difficulties in order to achieve benefits all around.

There is a strong case for London credit unions moving, as a priority, to a more collaborative credit union system in London. The importance of collaboration was recognised by credit union managers in the study and, with the support of the Legislative Reform Order⁴⁴, it will enable them to offer access to affordable credit, and to other financial services, to the whole of London, without the need for wholesale mergers or the creation of new credit unions. The challenge is now to make collaboration happen and, following on from this study, there is good argument that London credit unions should take the lead in building a collaborative alliance and be collectively some of the first credit unions to pioneer ABCUL's back office system.

⁴⁴The implementation of the Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2010 is regarded as a *conditio sine qua non* to the immediate and effective development of the credit union sector in London. Its implementation is not noted as a recommendation of this report, as this is presumed to have been agreed by the Coalition Government and only delayed by force of circumstances.

Community development finance institutions in London

3.1 Social enterprise and the provision of affordable credit

In London there are a number of community development finance institutions (CDFIs) and one social firm that are established to provide affordable credit to people for whom access to mainstream credit is difficult or impossible. Both CDFIs and social firms are businesses that have primarily social objectives, that invest in the community and that are not driven by the need to maximise profits for shareholders and owners.

Most CDFIs were created to enable micro-enterprises, small and medium sized businesses and social enterprises obtain the credit that they find difficult to access from banks and other mainstream providers. In recent years, nationwide many have also ventured into personal consumer lending. However, in London, there is only social firm active in consumer lending. Business enterprise lending remains the strength and primary concern of CDFIs in London.

CDFIs and social firms share the aim of contributing to building a cohesive and fair society by enabling entrepreneurs and individuals obtain the business loan or personal finance they are denied from the mainstream banking sector. Most take a holistic approach to their business and endeavour to ensure that access to credit goes hand-in-hand with financial advice and support. Unlike banks, CDFIs and social firms endeavour to reach out to marginalised and deprived individuals and groups, and endeavour to assist them to succeed in business and/or achieve financial stability.

3.2 Widening access to business lending

Exploring access to business lending was not originally part of the purpose of this study. Yet, in research discussions with partner organisations and stakeholders, it became clear that there was often a cross-over between access to personal and enterprise credit. Enabling people to access a business loan and create or develop an enterprise can have multiple ramifications within families and communities, potentially contributing to individual development and social cohesion in a way similar to, if not even greater than, that of access to a personal consumer loan. It was felt by research participants that an analysis of access to affordable credit in London was not complete without mention of those social finance institutions engaged in business lending in deprived communities in London.

There are five main CDFIs that lend to businesses in London. These are East London Small Business Centre Ltd, which serves east London; GLE oneLondon, which serves all of the capital; HBV Enterprise which serves North London and Hackney; North London Community Finance, which is based in Enfield and the Fredericks Foundation, which in fact only serves a small part of London, serving mostly southern counties. In addition, Fair Finance, an independent social firm, offers micro-enterprise as well as personal loans to anyone living or working in London. Fair Finance is based in Dalton in Hackney and currently has three branch offices in Ilford in Redbridge, Stepney in Tower Hamlets and Holloway in Islington.

CDFIs operating in London made 500 loans in 2010, totalling £6 million to micro and small businesses (1–50 employees). The total current loan book stands at 1,600 loans to a value of £12.5 million. In addition, Fair Finance, has a total current loan book of 170 loans to a value of £616k, and made about 16 business loans in 2010.

CDFIs also generally offer enterprise training, business support and advisory services aimed at enabling people take on the challenge of running their own business. HBV Enterprise, the charity based in Hackney, for example, explains their mission this way:

"We teach people about enterprise because it gives them new skills and better chances. They become more employable, and some go on to start and grow their own successful businesses, creating jobs along the way. We also help local people finance and grow their businesses, which stimulates the local economy." (HBV 2011)

Organisational and financial challenges

CDFIs established for business lending are currently facing a number of key organisational and financial challenges. Consultation with staff at the Community Finance Development Association (cdfa) identified the following as key issues currently being faced by the CDFI sector:

- Uncertainty over funding following the announced closure of the London Development Agency. There is concern that funds for operations which can help CDFIs grow and reach out to a greater number of clients will be curtailed.
- Cuts in funding to business support centres, such as Business Link, potentially will affect the quality of CDFI customers. Many CDFIs work closely with support centres to ensure their clients are investment ready, that is, have a decent business plan in place and have financial knowledge of running a business before taking on credit. Having a quality referral system from partners helps in ensuring CDFIs are efficient and effective in business lending.
- Concern about the future of the community investment tax relief (CITR) scheme. This exists to support private investment into accredited CDFIs that lend to business or social enterprises in deprived communities. It offers investors a 5% per annum tax relief of income or corporation tax over a five year period. The cdfa are currently lobbying the Government to extend the CITR scheme as it is up for renewal in 2012.

The clients of CDFIs do not fit the mainstream banks business model, and are best served by a locally-based and responsive community finance service

What would help CDFIs to develop?

There were two main areas of support identified by the cdfa that are required to assist the development of enterprise CDFIs; appropriate investment in the business and the development of business support and advice agencies, the latter for reasons noted above.

Apart from the continuation of the CITR scheme, it was seen as important that CDFIs secure funding from the Regional Growth Fund and the Big Society bank, both to create capital for on-lending funds and for revenue to cover the cost of operations. It was felt that banks need to recognise the work of CDFIs as complementing, or extending, credit facilities accessible through mainstream banking. The clients of CDFIs do not fit the mainstream banks business model, and are best served by a locally-based and responsive community finance service. Bank support for customer referrals and for commercial lending to CDFIs would help to establish a mature CDFI sector alongside mainstream banks and credit providers.

Regional Growth Fund

As this report was going into production, in April 2011, it was announced by Lord Heseltine that the cdfa had been awarded £60 million in funding under the Government's Regional Growth Fund scheme, the biggest ever investment available to CDFIs. The cdfa will receive £30 million allocation from the Regional Growth Fund and £30 million of bank finance over three years. This is significant recognition by Government of the importance of supporting business development in disadvantaged communities and a major step forward for the sector. Lord Heseltine, chair of the RGF Independent Advisory Panel, stated when making the announcement, that:

"I am pleased that a number of high street banks are joining the Government in supporting microfinance through the Community Development Finance Association. £30m of Regional Growth Fund will be matched by a further £30m from two banks. In addition we are in detailed discussion with the high street banks over options for schemes to get additional finance to small businesses in economically vulnerable parts of England."⁴⁵

⁴⁵ <http://www.cdffa.org.uk/2011/04/12/cdfi-sector-secures-60m-in-regional-growth-fund-announcement/>. April 2011

3.3 Widening access to personal consumer credit

There are no CDFIs involved in personal consumer lending in London, and only one social firm. This is Fair Finance. Currently 80% of its business is personal credit, up considerably since the firm was founded in 2005. Fair Finance endeavours to offer an integrated service aimed at building the financial inclusion and capability of its clients. To this end, it offers money and debt advice, through the subsidiary charity Fair Money Advice, to both personal and business borrowers living or working in Tower Hamlets, Hackney or Newham. 65% of Fair Finance's personal lending is in Tower Hamlets and Hackney

Fair Finance targets people who are unable to obtain loans from banks and other mainstream financial providers, or who have had a history of taking out loans with high-cost, sub-prime providers. Over 85% of its customers are on state benefits, nearly 60% are single mothers and fewer than 10% have any form of savings.

Faisal Rahman, the manager, explained that Fair Finance regards itself as an intermediary financial institution that works to bring financially excluded people into the mainstream. It offers clients access to affordable credit, but does so in a way that assists in a pathway to financial inclusion. High importance is given to building the credit rating of borrowers by uploading repayment data to the Experian credit reference agency and through advice and support, to enabling borrowers to move away from dependency on high-cost credit providers. Unlike credit unions, Fair Finance does not see itself as a long-term financial provider to individual clients, but rather as a conduit to more affordable options in the future.

All loan repayments are made by direct debit or, in some cases, by standing order, which necessitates Fair Finance assisting people to obtain a bank account if they do not have one already. Missed payments can be made up with cash payments in the offices but electronic loan repayment is the norm. This not only streamlines repayment but assists in the process of moving clients into the mainstream. In the case of Fair Finance, the move away from cash repayments is not regarded as undermining access to affordable credit, even if previously customers were used to managing household budgets and borrowings primarily in cash.

Fair Finance endeavours to offer an integrated service aimed at building the financial inclusion and capability of its clients

Credit administration

Fair Finance offers a standard personal loan to clients, for amounts from £50 up to £2,000. Currently all personal loans are made at the equivalent of a 44% APR interest rate, which includes a 5% arrangement fee. The average loan is around £700 (£680 in Tower Hamlets, and £730 in Hackney); somewhat higher than the London average of around £400 for Growth Fund loans available through credit unions.

Fair Finance has a rigorous credit application and assessment process which aims to be efficient, with a turnaround time of around 24 hours, and effective in ensuring that people have the capacity and the willingness to repay. Fair Finance is confident that people on low incomes, including those on welfare benefits, do have the capacity to borrow so long as they have basic skills in money management. Those who are declined a loan, are not declined on the basis of income, but on their ability to manage their finances. It is for this reason that the 20% of applicants who are declined are referred for money or debt advice, either to Fair Money Advice or to another external money advice agency.

The 44% APR charged on loans is calculated as the break-even rate for lending and is regarded as sustainable for the client base. On low value loans, the interest rate affords reasonable weekly or monthly repayments and is considerably less than the 300% plus APR charged by high-cost lenders, often the only credit option open to many of the clients.

Money and debt advice

Fair Money Advice was established as an independent subsidiary charity by Fair Finance in order to minimise conflicts of interest and to ensure clients received impartial advice. The provision of money and debt advice, and of financial education, is seen by Fair Finance as essential to enabling people to achieve financial stability.

Fair Finance employs a team of five money and debt advisers who serve people living or working in Tower Hamlets, Hackney or Newham. Low-income clients are targeted but the service is open to all in need of advice. The restriction to the three boroughs is due to agreements with the partner organisations, mostly social housing providers that fund the service for the social and economic benefit of particular local communities. There is a strong sense of community engagement reflected in the close working relationships Fair Finance maintains with its support organisations, and which impacts on the local nature of service delivery.

One key partnership initiative is the Money Matters Project organised in collaboration with social housing providers. In this project, a number of housing associations fund Fair Finance to provide specialist face-to-face debt advice to their tenants, to take on debt casework, to offer a telephone tenant debt advice service and to deliver project training sessions to their staff. This project depends primarily on referrals from housing association staff who are trained to spot tenants with financial difficulties and who would benefit from money and debt advice. This project also is able to access tenants to financial literacy training through the project and in other London locations.

Fair Finance is confident that access to debt advice has improved the financial resilience of people accessing the service. However, no specific longitudinal studies to measure progress have been undertaken.

Building the business

As the end of March 2010, Fair Finance had 1,000 active personal borrowers and a total personal loan book of £500k. The amount of consumer lending has risen by 66% since March 2008, when personal lending stood at around £400k. From 2005 to March 2010, Fair Finance has made 2202 personal loans to a total value of £1,965,900.

A commercial model of capital investment was required to expand the business

Undoubtedly, the expansion of the personal lending business was due in part to significant DWP investment through the Financial Inclusion Growth Fund. Fair Finance participated in the early stages of the Growth Fund, but then withdrew from the programme as it considered that loans could not be made effectively within the pricing margins set by the DWP, and that target-driven lending was not always in the best interest of the borrower. However, the capitalisation of the business through the Growth Fund has paid benefits and expanded the provision of credit considerably.

As most CDFIs, Fair Finance is dependent on generating funds for on-lending to its borrowers through share capital and social investments from individuals and companies. Share capital in Fair Finance is around £21k and so most funds have to come from external investment.

In interviews, the manager identified that the biggest challenge facing the business was attracting capital funds for on-lending. He argued that dependence on social investments would not generate sufficient capital long-term to significantly build the business throughout London. Not only are such social investments not guaranteed, they are unlikely to be of sufficient volume to meet demand.

He was of the opinion that a commercial model of capital investment was required to expand the business. This would involve banks or other institutions lending to Fair Finance at a reasonable interest rate, and then the funds generated would then be on-lent at around 44% APR to the target market. The spread between the cost of funds and the loan interest generated was considered as sufficient to finance a sustainable business. However, at the time of the research interview, Fair Finance had not yet been successful in convincing banks, or other institutions, to lend commercially to the business. They judged that the risk was too great and that the organisation had insufficient collateral to guarantee any loans made. This situation was change before the publication of this report, as noted below.

Reaching out to the financially excluded

Fair Finance reaches out into its target market mainly through word of mouth or through local advertising. The current strategy is to reach out to the financially excluded through a 'branch model' in which customers can access staff directly. The commitment to this model

is based on the understanding that many, particularly low-income people, “want a new type of relationship with their lender that the banks aren’t interested in providing”⁴⁶. This type of relationship is face-to-face and person centred. Indeed, research has continually confirmed the importance of the human touch and flexible, friendly, accessible services for those on low incomes, whether these are community finance services or money and debt advice. Fair Finance considers that SMS and telephone services can improve communication with existing clients but would not in themselves increase the numbers of clients.

Fair Finance is planning to open an additional ten staffed branches across London. With good local connections, it is considered that these branches would not only reach the financially excluded and underserved, but would be able to generate sufficient income to become self-sustaining.

Working in partnership in the community

Fair Finance has a strong commitment to the development of its services within the local community, a fact reflected in the make-up of its volunteer board of directors. All members of the board are selected on the basis of their close ties with local businesses and the community, and for their ability to contribute to the strategic planning of the organisation. There are currently nine members on the board, a size which is considered to be appropriate for the organisation.

Links with the local community are ensured through the local branch structure, and also through partnership working with social housing providers. Housing associations refer their tenants to Fair Finance for loans or for money and debt advice.

Organisational and financial challenges

For Fair Finance, expanding access to affordable credit throughout London is challenging, both organisationally and financially. Organisationally, as already noted, Fair Finance sees expansion primarily through an extension of the branch office network, but still lacks a sufficiently extensive network to reach communities throughout London. Branch offices are an expensive way forward, but Fair Finance regards local, accessible, face-to-face services as critical to success within the low-income market.

Despite the higher costs of the branch system, the organisation has found it possible to break-even on the personal lending business by driving down costs through the introduction of streamlined credit administration systems (including computerised loan administration), by increasing the volume of loans made, and by pricing loans economically at an equivalent of 44% APR. Bad debt on loans has been an issue, but is manageable through the implementation of rigorous credit control procedures. Clients with no repayment after 180 days are taken to court. This rigorous approach has resulted in a bad debt ratio of about 15% for loans greater than one day in arrears, and about 7% for loans over one month in arrears. This latter figure is up slightly on the 2008 ratio of 5%.

The greatest challenge facing Fair Finance, as outlined previously, is that of raising sufficient capital funds for on-lending. Even though Fair Finance has successfully raised nearly £1million in social investment funds, this is still regarded as insufficient to meet the credit needs of communities throughout the capital.

Given the reluctance of the banks to lend commercially to the business, the manager argued strongly that more work needs to be done to persuade banks to consider lending against the Fair Finance loan book, currently seen by banks as of limited value given the risks involved. In this regard, some form of guarantee fund, established by Government or other institutions, would be of assistance in leveraging in bank support.

Despite the higher costs of the branch system, the organisation has found it possible to break-even on the personal lending business by driving down costs through the introduction of streamlined credit administration systems

⁴⁶Faisal Rahman, The Guardian <http://www.guardian.co.uk/theguardian>, Wednesday 26 May 2010

Stop press! – Santander supports Fair Finance with access to commercial funding

Just as this report was going into publication, Santander announced that a commercial funding agreement had been made with Fair Finance which would enable the organisation to extend its operations throughout London. A £2 million commercial loan has been granted by Santander in association with Société Générale and BNP Paribas. £750,000 of angel investment has been offered as security against the loan, renewable after five years.

This significant investment, contrary to the manager's expectations when interviewed as part of this study, will be used for on-lending and to expand Fair Finance to a network of 14 branches in low-income communities across London.

The future of the credit unions and social finance sector in London

4.1 Opportunities for growth and expansion

This aim of this study was to investigate access to affordable credit through community finance organisations in Greater London, to identify those areas where a gap exists between existing supply and demand, and to analyse the potential of existing organisations to develop and to grow to meet that demand.

In reality, the study has focused primarily on the credit union sector. For apart from one social firm, Fair Finance, credit unions are the only community finance organisations engaged in the provision of affordable credit in low and moderate income communities in the capital.

The credit union sector

The ability of London's credit unions to undergo organisational reform has been clearly evidenced through this study. Over the last decade, many credit unions in the capital have changed and expanded out of all recognition; and a number have developed into significant providers of lower-cost financial services. Credit union membership in London has grown over 90% since 2005, and is growing now faster than the national average.

Confidence in the capacity of credit unions to improve organisational competence has been strengthened by the sector's overall performance in delivering the Financial Inclusion Growth Fund. Not only did independent evaluation demonstrate that credit unions had achieved what they were tasked to achieve (Collard et al., 2010) but separate DWP analysis identified significant social benefit savings for Government brought about through Growth Fund delivery⁴⁷. For Government, and for the majority of credit unions, the success of the Growth Fund was that it was able to reach out to thousands of people in need of affordable credit and also, at the same time, strengthen the capacity of the sector to deliver.

The renewed confidence of Government in the credit union sector resulted in The Minister of State, Department for Work and Pensions, Chris Grayling, making the following statement in the House of Commons in March 2011:

"I am therefore pleased to announce this Department's continuing support for credit unions, building on the existing Growth Fund, and providing the new funding required for further expansion. This modernisation fund, worth up to £73 million over the next four years, will support those credit unions who are ready and prepared to step up to the plate – to expand their service to benefit more customers.

My Department will work with the credit unions to look at ways in which the future progress of this sector can best be supported. This includes the possible development of a shared banking platform, for which funding has already been set aside. Subject to successful feasibility studies, this will open up opportunities for many more people to access credit union services, including through the Post Office network."⁴⁸

The capacity of credit unions to deliver is recognised by the Minister, but it is clear that further Government support for the sector will depend on credit unions being "ready and prepared to step up to the plate" and modernise in a way that ensures that many more people would be able access credit union services. Government is encouraged by credit union performance but is now looking for a step-change in credit union development and organisational capacity that would enable people to access services in new and more innovative ways, including through the Post Office.

⁴⁷ DWP contract Information Note 019 – March 2011, sent to all Growth Fund credit unions.

⁴⁸ Written Ministerial Statements for 3 March 2011. Hansard. HM Government

"My Department will work with the credit unions to look at ways in which the future progress of this sector can best be supported"
Mr. Chris Grayling MP

This call for a step change in organisation and capacity reflects the same concerns reiterated by local authorities, social landlords and others in the course of this study. Like them, Government wants credit unions to modernise systems and operations and to be able to deliver quality financial services effectively to people on both low and moderate incomes. The challenge thrown down to credit unions by the Minister is perhaps the greatest opportunity for growth and expansion in the history of the credit union movement in Britain. For with the challenge comes the promise of significant financial investment to modernise operations through the development of a shared electronic banking platform. This has the potential to initiate a major technological advance in the British credit union movement and to propel credit unions collectively, in London and elsewhere, into the 21st century.

It is significant that the Minister referred to enabling people to access credit union services, rather to affordable credit alone, and also to opening up the opportunity of credit union membership to many more people, not just to those on the lowest of incomes. This aligns with the themes of the pathway to financial stability and of refocusing credit unions to serve a wider segment of the low and moderate income market, which emerged strongly in this study. Credit unions realise that product diversification and serving a wider population are imperative if they to fulfil their purpose of serving the financial needs of modern consumers, including those on low incomes, and if they are to achieve long-term economic sustainability.

The diversification of products and services and serving needs of a wider segment of the market in no way means that credit unions are moving away from serving the poor and those on low incomes. On the contrary, the commitment to the poor surfaced strongly in this study. But people on low incomes are best served by enabling them to access savings and transaction accounts, as well as affordable credit, within an inclusive community finance institution open to all, rather than one that is stereotyped as a service for the poor.

The challenge thrown down to credit unions by the Minister is perhaps the greatest opportunity for growth and expansion in the history of the credit union movement in Britain

Stepping up to the plate, however, as this study has argued, will be a major challenge for credit unions. The ability to expand the provision of affordable financial services to many more consumers, on both low and moderate incomes, will depend ultimately on their economic strength, organisational capacity and operational efficiency. It will be dependent on a radical change in multiple aspects of credit union policy, practice, organisational structure, as well as in product diversification, upgrading of buildings and information technology and in the modernisation of service delivery, all of which have to be addressed simultaneously. It will involve development in business and market-oriented strategic planning, strengthening financial discipline, as well directors and staff rethinking governance, leadership and management in their totality.

At the outset of this study, there was a temptation among some participants to look for a magic button to enable credit unions to serve the whole of London at a stroke with affordable credit and other financial services. But such a button does not exist, the potential for credit union growth and expansion can only be realised on the basis of radical and contemporaneous organisational reform in multiple areas of the business.

The history of the development of credit unions in London, and the reform and transformation that they have already achieved to date, gives confidence in their ability to respond to the challenge of further organisational reform and reengineering of the business.

However, this time, the context and the challenge are significantly different to anything that has happened in the past. As this study has argued, previous reform has focused on atomistic credit union development, linked with moves to achieve economies of scale through transfers of engagement. But, as has also been argued, this approach is under strain. Individual credit unions lack the resources, infrastructure and skill to achieve the goal of enabling Londoners to access to the kinds of quality, modernised products and services as envisaged by the Minister. Even the largest credit unions, despite eminent success, would be unable to offer the level of service and access, for example that would be provided by a link with the Post Office.

The conclusion of this study is that credit unions in London have now have an opportunity for growth and expansion, and together, have the ability and competence to ensure credit unions become significant community finance institutions with a capacity to serve large numbers of people, if only they would commit to major collaboration within the sector.

This study strongly argues that there is a compelling case for a move away from an atomistic business model to one based on collaboration and shared services. It is collaboration that offers a real opportunity to build scale and efficiency in the sector whilst maintaining the community finance ethos and vision that defines and differentiates it from the mainstream.

If credit unions shy away from collaboration, and the introduction of electronic back office services, the larger, more successful credit unions will continue to develop according to their current business model, others will transfer engagements, close or stagnate, but the opportunity for a major radical structuring of the business will be lost. In fact without collaboration, there will be no real future for the movement as a whole in London as a meaningful alternative provider of quality affordable financial services on any scale.

The importance of collaboration to the sustainable development of the credit union sector does not just apply to London; it is currently a world issue. In a 2008 Filene Research Institute colloquium at the University of Pennsylvania, credit unions participants stressed the reality of situation facing credit unions in the US as elsewhere:

“The business model is broken: Over a long period of time the credit union business model has deteriorated. Margins have declined while operating expenses have increased – a situation an old accounting professor of mine called “the Death Spiral.”

The Filene Research Institute invites the entire credit union system to pause and consider the implications, benefits, and power of collaboration. The credit union system has the moving parts, resources, and ability to collaborate. It only requires the will of the credit union system to make large-scale collaboration happen.” (Filene 2008)

This study strongly argues that there is a compelling case for a move away from an atomistic business model to one based on collaboration and shared services

The CDFI and social finance sector

This study has argued that the CDFI and the social finance sector are an important part of the landscape of access to affordable credit. In regard to CDFIs, enabling people to access a business loan to develop an enterprise can potentially contribute to individual development and social cohesion in a way similar to, if not even greater than, that of access to a personal consumer loan. The one social firm in the capital enables a significant number of people, often in the most financially excluded circumstances, to access a loan at a more affordable rate of interest than high-cost credit providers.

Of course, the CDFI and social finance business model and objectives are very different to those of the credit union sector. As has been explored in the study, the greatest challenge they often face is accessing external capital or funds to on-lend to their customer base. Both the CDFI and social finance sector in London have made significant progress in this regard during the course of this study. But of course, accessing capital is only the first part of the story. Like credit unions, CDFIs and social firms have to achieve organisational efficiency, scale economies and quality in service delivery to ensure long-term sustainable success.

4.2 The challenge of radical change within the credit union sector

The outcome of this study is a vision of credit unions in London collaborating to drive scale, efficiency, and performance. The chapters of the report offer a blue-print of a road-map to making this vision a reality. Achieving the vision will involve a radical change in the development of credit unions, from the stand-alone model that has characterised much development of the past to one that prioritises commonality over uniqueness.

The change to a collaborative model will not be easy for many credit union directors, managers and staff in London or elsewhere. Credit union achievement, success and career plans have been intimately linked to the stand-alone credit union model since the beginning of the movement in Britain. It will involve people accepting that collaboration will enhance individual success, rather than undermine it and that it will strengthen a credit union movement based on localism and community engagement. Collaboration is a radical alternative to large

scale mergers and one that is designed to ensure smaller credit unions can offer the same level of service and product offering as their larger cousins.

Directors, managers and staff, however, will undoubtedly dwell on the risks of collaboration; but this study argues that the risks of bowling alone are much greater than the calculated risks in large scale collaboration. It is for this reason it is imperative that credit union boards and managers begin to orient their strategic thinking towards collaboration and in wider terms than their own credit union's success. Of course, there are examples to build on within the credit union movement itself. The Credit Union Current Account could not have come about except through widespread collaboration.

The study has argued that information technology, the electronic hub or ABCUL's back office proposal, is the sine qua non of collaboration. It is the kit that makes collaboration possible. But it is not in itself collaboration. Collaboration is a decision, a commitment and a mind-set that prioritises co-operative endeavour and structures for the advantage and success of all. In fact, it is based more on trust and a common vision than on technological kit.

But the move to the electronic back office concept is key to the process, and making it work is important. Credit unions in London, as elsewhere in the country, now have the opportunity and the possibility of taking a major step-forward forward in organisation and service delivery. It is a step forward rather than a leap, for as the study has argued, collaboration often starts with short-term wins, and has highlighted the possibility of immediate collaboration on credit scoring and administration and controlling bad debt.

This report presents the challenge of radical change within the credit union sector, and argues that collaboration should now be basis of strategic thinking in the boardroom and among CEOs and managers and on training courses throughout the sector. Collaboration may seem a new idea, but it is as old as the co-operative movement of which credit unions form a part. In the 19th century, Robert Owen, one of the founding fathers of the co-operative movement, was arguing for the same concept on which credit union development in the 21st century needs to be based:

"There is but one mode by which man can possess in perpetuity all the happiness which his nature is capable of enjoying, – that is by the union and co-operation of ALL for the benefit of EACH." (Robert Owen 1826)⁴⁹

It is imperative that credit union boards and managers begin to orient their strategic thinking towards collaboration

⁴⁹ Robert Owen (1826) The Social System – Constitution, Laws, and Regulations of a Community

Recommendations

These recommendations arise out of the research into the expansion of affordable credit across London and relate to the credit union and CDFI sectors (the latter for the purposes of this report understood to include social firms). Consultations on the recommendations have taken place as part of the study but they remain those of the authors.

Most recommendations relate to credit unions and CDFIs, but there are also a number for central government, local government and partner organisations. These indicate ways in which external agencies can engage with credit unions and CDFIs and support the expansion of their services within low and moderate income communities in London.

Credit unions and CDFIs in London

In Britain, credit unions and CDFIs represent two distinct sectors within the field of not-for-profit community finance. There are many constitutional and operational differences between the two sectors, but they share a common commitment to assist people to access fair and affordable financial services appropriate to their needs. Both sectors represent financial institutions that are committed to serving those not served or underserved by mainstream financial providers and to fighting poverty in low-income communities.

Credit unions and CDFIs offer people a real alternative to using high-cost financial providers and, as this study has shown, they have established themselves in communities throughout London. However, service penetration still remains relatively low in relation to the level of need for affordable financial services in the capital. These recommendations aim to support the strengthening and expansion of both sectors.

Credit unions in London

1. Communicating the credit union vision

Credit unions represent by far the largest community finance sector in London. As co-operative, self-help financial institutions, they are member-owned and locally controlled and are actively engaged in enabling their members to achieve financial health and security. The vision is to offer quality and affordable financial services to all Londoners, but credit unions are particularly concerned to target access to those on low and moderate incomes.

- It is recommended that credit unions formulate a clear statement of purpose and quality in management and operations as an essential first step to communicating the vision of a modern credit union service delivery, and to ensuring effective partnership working with external organisations.

What partners and other organisations can do to help:

- It is recommended that Central Government, Local Government, social housing providers and other agencies engage with an increasingly modernised and professional credit union movement in London, and regard credit unions as partners in revitalising and strengthening local communities.
- Partners and other organisations should regard credit unions as organisations with which they can do business to achieve social and economic objectives.

2. Building confidence in credit unions

Establishing credit unions effectively in communities and work-places depends on building the confidence and trust of members and of the general public in their financial stability and in the quality of their service delivery.

- It is recommended that credit unions prioritise building the confidence of local authorities, social housing providers and others in the capacity of all credit unions to deliver quality financial services.
- It is recommended that weak or stagnant credit unions that find it difficult to develop as long-term modern sustainable businesses seek transfers of engagement into stronger credit unions, particularly where there is danger of credit union collapse.

What partners and other organisations can do to help:

- Partners and other organisations should consider supporting credit unions through training and mentoring opportunities, allowing staff to transfer their skills and competencies into a growing credit union sector. Local authorities should explore the possibility of seconding staff into credit unions.
- It is recommended that banks develop a greater role in supporting the credit union sector in order that it can expand access to affordable credit and other financial services within low-income communities in London. There is an important role for banks in the development of volunteering programmes for managerial and technical staff to directly assist credit unions in London.
- It is recommended that partners and other organisations develop an in-kind-assistance to credit unions to develop premises and infrastructure. This could include the use of disused bank branches or other buildings and the gift of IT and other equipment. Modern physical presence in the community inspires confidence.
- It is recommended that the FSA and the new regulatory bodies ensure compliance in a way that is appropriate to the sector.

3. Expanding access to credit unions

Credit union products and services are increasingly accessible through the expansion of the credit union movement in London. However, they are not yet accessible everywhere and, in particular, there are a number of boroughs still not served by credit unions.

It is recommended that credit unions work with their partner organisations to:

- Prioritise the development of a wider range of savings and loan products that meet the needs of low and moderate income working people. The quality of products and services on offer is one of the most important factors in attracting people to join credit unions
- Prioritise expanding access within their existing common bonds, through greater outreach in the community, and partnerships with local authorities and government departments, companies, social housing providers and others. Evidence suggests that credit unions attract low-income members primarily through word of mouth and personal recommendation.
- Preserve face-to-face and local service delivery through credit union branches and community outreach service points, with the proviso that the use and location of branches be carefully considered to balance the benefits with the costs and the possibility of replacing them with electronic delivery channels where appropriate
- Introduce modern electronic delivery channels for financial services in London. These would include internet and telephone access, SMS and mobile phone technology, the Credit Union Current Account with ATM access and debit card facilities and pre-paid debit cards.
- Collaborate where appropriate on expansion strategies into neighbouring boroughs. It is recommended that credit union expansion throughout London is undertaken organically and incrementally, and in accordance with sound business planning, in order to ensure the safety and soundness of expanding credit unions.
- Take advantage of the new, more flexible approaches to the common bond defined in forthcoming legislation. This will enable widening access to credit unions products and services through the creation of new fields of membership in partnership with social

housing providers, employers and other organisations, and without a necessity to expand geographically.

- Pioneer the link with the Post Office, which has the potential to open up access to credit union products and services significantly. ABCUL's planned banking platform will enable Post Office staff to offer 80% of the services available face-to-face in the credit union.
- Recognise that there are limits to the risk that credit unions as social businesses can realistically be expected to take on when widening access to services. Some people are not served best by access to more credit.
- Build greater awareness of credit unions by taking part in the development of the collaborative internet website for credit unions and CDFIs in London, currently being pioneered by the financial inclusion champions. This website should clearly state the collective purpose and vision of credit unions within London and offer online access to credit union information and application forms

In addition, it is recommended that government departments, local authorities and employers in London encourage staff members to join credit unions by offering them payroll deduction facilities as a default employment benefit.

4. Prioritising serving those on low and moderate incomes

All credit unions in the study placed high importance on serving people on low and moderate incomes, particularly those who were not served or under-served by mainstream financial providers and who had little option to access credit except through high-cost sub-prime providers. However, all credit unions realised the economic and social importance of diversifying the business and serving members from a range of economic backgrounds.

- It is recommended that the provision of affordable credit, and other financial services, to financially excluded and low-income communities in London should be set within the wider context of providing financial services to the population at large.

What partners and others can do to help:

- Partners and other organisations can help by ensuring that credit unions are presented as co-operative, mutual financial institutions open and accessible to all. They should avoid any terminology or reference that implies that credit unions are solely for poor people.

5. Strengthening credit unions

Building confidence in credit unions and expanding access to credit union services depends on their being strong, stable and safe financial institutions. Over the last ten years, there has been a significant transformation in the organisational capacity and good management of most London credit unions. It is recommended that the priority to strengthen the credit union movement in London continues.

Governance, good management and volunteer engagement

- It is recommended as a priority that credit unions continue not only to strengthen management and technical expertise throughout the sector as a whole, but endeavour to achieve a step change in management skills and capacity among credit unions that aim to lead on developing financial services and affordable credit for London.
- It is recommended that all credit unions continue to prioritise good governance and adhere closely to the Code of Governance for Credit Unions adopted by the sector.
- It is recommended that credit unions retain and strengthen their focus on volunteering in credit unions, whether related to governance, to offering technical skills and expertise, or to engaging volunteers in operational support. Volunteering arises from and contributes to credit union engagement in local communities and assists in the development of self-help initiatives at a local level.

What partners and others can do to help:

- It is recommended that partners and other organisations could commit to developing credit union volunteering programmes and place greater emphasis on attracting highly-skilled volunteers from among their own workforce or associates, to offer specialist technical and management skills to credit unions.
- It is recommended particularly that banks and financial sector institutions establish a management skills and technical expertise assistance programme for credit unions in areas such as general management and marketing, systems and procedures, managing bad debt, human resource management. This programme could involve training opportunities for credit union personnel and the secondment of bank staff into credit unions. Skills transfer will be a key element in supporting effective credit union development

Collaborative approaches and systems

- Credit unions should recognise, in common with many credit union movements worldwide, that long-term success in expanding access to affordable credit union financial services depends on the development of a collaborative credit union system.
- Collaboration not only improves performance, efficiency and standardisation in quality of service, it safeguards diversity and localism in credit union services.
- It is recommended that collaboration among credit unions includes live-or-work, associational and employee credit unions, all of which, in their own way, offer financial services to Londoners.
- It is recommended that London credit unions prioritise the move towards a collaborative system and begin to make the cultural and organisation changes to make this happen.
- It is recommended that London credit unions take a lead in participating in ABCUL's new back office project as a focus for credit union development and promotion within London. It is recommended that credit unions interested in collaboration form a coalition to generate a sense of urgency about the issue in London.
- It is recommended that London credit unions find a way to participate in ABCUL's collaborative credit assessment and debt recovery projects, as immediate short-term wins in the move to greater collaboration.

What partners and others can do to help:

- It is recommended that Government supports and financially contributes to the creation of ABCUL's new back office project, which includes the centrally-managed banking platform which is the cornerstone of an effective collaborative credit union system, and a range of services that potentially may be outsourced on behalf of participating credit unions. The banking platform will allow credit unions to collectively do business with outside agencies, including the Post Office and the DWP.

Financial discipline and investment

- The Financial Inclusion Growth Fund, and other sources of external capital for on-lending, has stimulated growth within the London credit union sector. However, long-term, it is recommended that credit unions continue to focus on retail savings maximisation as the primary means of generating funds for on-lending.
- It is recommended that credit unions more rigorously cost their lending activities. It is clear that there are often higher costs associated with serving some financially vulnerable members with low value loans.
- It is recommended that an increase in the interest rate cap on credit union loans be considered by credit unions in London and nationally. A rise in the interest rate could have a significant impact on a credit union's ability to meet costs and to achieve financial sustainability, and

would be a significant factor in successfully serving the low-income market, which will otherwise be difficult to achieve without significant subsidy for such lending.

What partners and others can do to help:

- It is recommended that Government supports the current advance in the credit union sector in London by facilitating capital investment into credit unions for on-lending to people on lower incomes.
- It is also recommended that Government ensures sufficient ongoing revenue support to enable near-sustainable credit unions to achieve financial stability, and the more economically vulnerable to transfer engagements into neighbouring credit unions.
- It is recommended that banks adopt a role in capitalising credit unions through low-cost loans, subordinated debt and other measures, which can enable credit unions to create credit in low-income communities.

Community development finance institutions

The research study only revealed one social firm, Fair Finance, engaged in providing affordable personal consumer loans in low-income communities in London. However, a number of other CDFIs, including Fair Finance, were identified as being involved in enterprise lending in low-income communities or to business entrepreneurs who found access to mainstream finance difficult.

1. The potential of CDFI expansion in London

It was recognised in the study that access to affordable enterprise loans for entrepreneurs in small businesses was an important part of the creation of the social fabric and capital of low-income communities in London. Indeed, many personal loans in CDFIs can also be associated with a small business or enterprise purpose. Given the extent of the demand for affordable personal and enterprise credit in London, CDFIs have an important contribution to make to the non-for-profit sector as a whole.

- It is recommended that CDFIs operating in London consider the business potential of expanding access to affordable personal credit within low-income communities.

What partners and others can do to help:

- It is recommended that Government, Local Government and others regard CDFIs as community-based organisations which they can support to achieve social and economic objectives.
- It is recommended that banks develop a greater role in supporting the CDFI sector in order that it can expand access to affordable credit and other financial services within low-income communities in London.
- It is recommended that banks consider commercial lending to CDFIs against their current loan book. The inability of CDFIs to assure greater access to capital funds for on-lending is restricting CDFIs expanding access to affordable credit in low-income communities.
- It is recommended that partners and other organisations consider supporting the creation of a CDFI loan guarantee fund in order to leverage bank support for the CDFI sector.

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Appendix I London credit Union membership

The figures indicate the membership of credit unions existing in London in 2010. The figures for asterisked (*) credit unions were not able to be verified with the credit unions concerned and are estimated on the previous year's figures. The table indicates significant growth over the period.

A Live-or-work, and residential credit unions – open to all in the locality

Name CU	London Borough	Membership, all 30th September, end of Year dates, except 2011					
		1999	2000	2005	2009	2010	2011 (March) estimated
1. Camden Plus	Camden	-	-	-	897	1,000	1,150
2. Croydon, Sutton and Merton	Croydon, Sutton & Merton	350	474	539	1,458	1,800	2,075
3. Ealing	Ealing and Brent	221	252	510	819	850	880
4. Greenwich	Greenwich	645	823	2,327	3,782	4,070	4,200
5. Hammersmith & Fulham	Hammersmith	-	-	-	898	1,300	1,565
6. Hillingdon	Hillingdon	463	500	900	1,271	2,230	2,500
7. Haringey, Islington & City	Islington, Haringay City of London	215	220	248	1,060	1,710	2,000
8. Lewisham Plus	Lewisham and Bromley	280	469	1,385	4,245	5,100	6,150
9. Liberty	Havering and Barking & Dagenham	-	-	300	594	700	960
10. London Mutual	Southwark, Lambeth	1,705	1,991	4,454	10,660	12,045	12,500
11. M4 Money	Hillingdon and Harrow	-	-	208	340	700	725
12. Newcred Community	Newham	-	-	2,912	4,274	4,975	5,260
13. North West London ⁵⁵	Barnet	145	315	873	2,083	1,310	1,330
14. Pimlico	Westminster	300	299	250	247	?	
15. Shrine Co-operative	Brent	495	527	n/a	146	134	134
16. Thamesbank	Hounslow	-	-	-	723	800	820
17. London Community	Tower Hamlets, Hackney	-	-	2,861	6,864	10,429	11,600
18. Waltham Forest Community	Waltham Forest	-	-	800	2,293	2,910	3,400
19. Wandsworth Community	Wandsworth	124	112	103	26	30	30
20. Greenlight	Tower Hamlets	n/a	n/a	n/a	n/a	n/a	n/a
21. Hornsey	Haringay	n/a	n/a	n/a	n/a	n/a	n/a
Subtotal – live-or-work / residential		4,943	5,982	18,670	42,680	52,093	55,206

⁵⁵ North West London Credit Union is a merger between three pre-existing credit unions (i) Barnet CU, (ii) Finchley CU and Watling and Graham Park CU. The merger took place in 2010

B Employee and Associational credit unions – membership defined by employment or associational affiliation

Name CU	London Borough	Membership, all 30th September, end of Year dates				
		1999	2000	2005	2009	2010
22. London Adventist	London	n/a	n/a	n/a	600	600*
23. Caribbean Parents Group	West London (6 boroughs)	75	93	196	196	196*
24. Croydon Caribbean	Croydon	465	497	545	615	650
25. Crownsavers (Lewisham Council Employees)	Lewisham	472	575	1,195	1,035	1,600
26. LTDA (Taxi)	London	2,078	2,025	1,533	1,399	1,399*
27. North London Credit Union	Enfield Barnet Haringey	549	575	354	540	600
28. Radio Taxicab (London)	London	531	599	572	588	588*
29. Rainbow	South East	149	217	440	715	740
30. Waltham Forest Council Employees	Waltham Forest	445	483	632	813	813*
31. RMT Credit Union Ltd	National	n/a	n/a	n/a	n/a	n/a
32. Plane Saver ³⁶	National	3,177	3,425	4,969	6,600	7,250
33. London Fire Savers	National, mostly London	754	913	1,220	1,867	1,867*
34. National Federation of Retail Newsagents	National	-	-	-	99	110
35. Pentecostal Credit Union	National	n/a	n/a	n/a	n/a	n/a
		13,638	15,384	30,326	59,149	
Subtotal –employee and associational		8695	9402	11656	15067	16413
Total credit union membership in London		13,638	15,384	30,326	57,747	68,506

Note: Total population of Greater London in 2010 was circa 7.6 million. Credit unions are therefore serving approximately 0.9% of the population. However, the data from a few credit unions is missing from the above list, so it can be safely estimated therefore that credit unions are currently serving around 1% of the population of Greater London.

⁵¹ Nearly all of the members of Plane Saver are either living or working in London

Appendix II London credit unions by borough

(Note shaded boroughs are served by a credit union offering financial services to all who live or work within the borough boundary)

A Inner London boroughs

London borough	Credit Unions in the borough. * indicates a multi-borough credit union	Open to all who live or work in the borough	Credit Unions considering operating in the borough
1. City of London Corporation	Haringey, Islington & City Credit Union*	1	
2. Camden	Camden Credit Union	2	
3. Greenwich	Greenwich Credit Union	3	
4. Hackney	London Community Credit Union*	4	
5. Hammersmith	Hammersmith and Fulham Credit Union	5	
6. Islington	Haringey, Islington & City Credit Union*	6	
7. Kensington and Chelsea			A study group in the borough is currently looking at options.
8. Lambeth	London Mutual Credit Union*	7	
9. Lewisham	Lewisham Plus Credit Union Crownsavers Employees Credit Union (not open common bond)	8	
10. Southwark	London Mutual Credit Union*	9	
11. Tower Hamlets	London Community Credit Union*	10	
12. Wandsworth	Wandsworth Credit Union (less than 40 members)		
13. Westminster			No credit union operating

B Outer London boroughs

London borough	Credit Unions in the borough	Serving entire borough	Credit Unions considering operating in the borough
14. Barking and Dagenham	Liberty Credit Union*	11	
15. Barnet	North West London CU	12	
16. Bexley	Greenwich Credit Union (Thamesmead area only)		No borough-wide credit union
17. Brent	Ealing Credit Union* North West London Credit Union (parts only)	13	
18. Bromley	Lewisham Plus CU*	14	

Appendix III Establishing a new credit union in London

ABCUL has supported development of several new credit unions in London over the last ten years. This has led to an understanding of broad set up costs over the first four or five years until the credit union is generating sufficient (primarily) loan interest to cover operating expenses. As expected, the major costs are staff and premises. In London the latter is particularly problematic in relation to the cost of shop front premises. The following (conservative) tables show approximately £400-£500k is required over 4-5 years. This is represented below as the earnings deficit of £445,701 over the first five years shown in red.

Expenditure

Staffing

Year	Manager	Accou/ Admin.	Clerical Staff	Total Staff	Total			
Year 1	1	40,000	1.0	17,000	0.0	12,000	2.0	57,000
Year 2	1	41,200	1.5	17,510	0.0	12,360	2.5	67,465
Year 3	1	42,436	2.0	18,035	0.0	12,731	3.0	78,507
Year 4	1	43,709	2.0	18,576	1.0	13,113	4.0	93,975
Year 5	1	45,020	2.0	19,134	1.0	13,506	4.0	96,794

Operating Expenses

	Year 1	Year 2	Year 3	Year 4	Year 5
Salaries and Benefits	57,000	67,465	78,507	93,975	96,794
Loan Protection (LP) Insurance	247	1,236	3,608	7,512	12,421
Life Savings (LS) Insurance	393	1,966	5,740	11,951	19,761
Insurances for credit union	400	400	600	600	600
Misc. Staff Expenses	3,000	3,750	4,500	6,000	6,000
Volunteer Expenses	2,000	2,040	2,081	2,122	2,165
Rent and Occupancy	35,000	35,000	35,000	35,000	35,000
Office Supplies/Printing /copying	2,000	2,040	2,081	2,122	2,165
Telephone	2,000	4,000	6,000	8,000	8,889
Marketing Materials	5,000	5,100	5,202	5,306	5,412
Computer Software Maintenance	3,000	6,000	9,000	12,000	13,333
Postage	189	567	945	1,323	1,596
Audit	2,000	2,040	2,081	2,122	2,165
Legal/Consultants	1,000	1,020	1,040	1,061	1,082
Staff/Board Training	2,600	2,625	2,650	2,700	2,700
ABCUL Dues	293	878	2,588	3,623	4,370
Depreciation	3,333	6,667	10,000	13,333	14,815
Provision for bad debt	281	2,948	10,358	25,012	41,988
Start up Expenses (see Sheet)	70,500				
Total Expenses	192,236	147,741	183,980	235,763	273,256

Income

	Year 1	Year 2	Year 3	Year 4	Year 5
Total income from earnings on loans, investments and joining fees	5,923	37,058	122,932	291,744	486,926

Summary

	Year 1	Year 2	Year 3	Year 4	Year 5
End of year total members	900	1,800	2,700	3,600	4,000
Average shares/member	£52	£156	£288	£441	£614
Loan/share ratio	60%	70%	80%	90%	90%
Average loans/member	£31	£109	£230	£397	£552
Monthly loan interest rate	2.00%	2.00%	2.00%	2.00%	2.00%
Targeted annual dividend rate	1.0%	1.5%	2.0%	2.0%	2.0%
Net Earnings on Loans	3,229	33,907	119,112	287,641	482,862
Net Profit (incl transfers to reserves)	2,378	13,179	43,426	84,655	213,670

(NB Inflation 2%, Earnings on Investments 1%, Member Joining Fee £3)

Income – expenditure – distributed to profit and transfers to reserves = earnings shortfall

(including transfers to reserves see above)

	Year 1	Year 2	Year 3	Year 4	Year 5
Total £445,701	188,691	123,862	104,474	28,674	0

Appendix IV Credit unions and the social firm participating in the study

1. Camden Plus Credit Union Ltd

347 Royal College Street
London NW1 9QS
Tel: 020 7482 3505

2. Croydon, Sutton and Merton Credit Union Ltd

Credit Union Office
Taberner House
Park Lane
Croydon CR9 3JS
Tel: 020 8760 5711

3. Ealing Credit Union Ltd

c/o Credit Union Solutions
Bungalow
Pinkwell Lane
Hayes
Middlesex UB3 1PE
Tel: 020 8573 8010

4. Greenwich Credit Union Ltd

48 Thomas St.
Woolwich
London SE18 6HT
Tel: 020 8855 4344

5. Hammersmith and Fulham Credit Union Ltd

274 North End Road
Fulham
London SW6 1NJ
Tel: 020 7471 2620

6. Haringey, Islington and City Credit Union Ltd

Caxton House
129 Saint John's Way
London N19 3RQ
Tel: 020 7561 1786

7. Lewisham Plus Credit Union Ltd

262 Kirkdale
Sydenham
London SE26 4RS
Tel: 020 8778 4738

8. Liberty Credit Union Ltd

Community House
19-21 Eastern Rd
Romford
Essex RM1 3NH
Tel: 01708 741899

9. London Mutual Credit Union Ltd

79 Denmark Hill
London SE5 8RS
Tel: 020 7787 0770

10. M4 Money Credit Union Ltd

c/o Credit Union Solutions
Bungalow
Pinkwell Lane
Hayes
Middlesex UB3 1PE
Tel: 020 8573 8010

11. Newcred Community Credit Union Ltd

1 Water Lane
Stratford
London E15 4LU
Tel: 020 85555388

12. North West London Credit Union Ltd

One Stop Shop
4-5 The Concourse
Grahame Park
London NW9 5XB
Tel: 020 8200 0770

13. Thamesbank Credit Union Ltd

c/o Credit Union Solutions
Bungalow
Pinkwell Lane
Hayes
Middlesex UB3 1PE
Tel: 020 8573 8010

14. London Community Credit Union Ltd

473 Bethnal Green Road
London E2 9QH
Tel: 020 7729 9218

15. Waltham Forest Community Credit Union Ltd

4 Church Hill
Walthamstow
London E17 3AG
Tel: 020 8520 8740

16. Fair Finance (social firm)

18 Ashwin Street
Dalston
London E8 3DL
Tel: 020 7254 1976

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