

The relationship between credit union objects and cooperative philosophies.

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ABSTRACT

To put the objects of credit unions into context within the co-operative movement, the history of co-operative institutions and the development of international co-operative principles are explained. This sets the stage for analysing how the credit union philosophies fit within international co-operative philosophies. Research on credit union objective functions and how these can be interpreted in the light of common co-operative principles is considered.

It is concluded that variant objective functions exist within credit unions. This is caused by the unique ownership structure and the diversity of objects that are required under credit union legislation. Economic models suggested (a priori) to explain the behaviour of credit unions couldn't be discounted, as different credit unions may interpret the purpose of the principles in different ways and may also try to achieve these objectives by different means. Hence, it could be concluded that some credit unions follow economic objectives in an attempt to achieve the co-operative principles. It is also suggested that credit union behaviour converges with the behaviour of other financial institutions as size increases.

Introduction

Credit unions are defined by Berthoud and Hinton (1989) as being co-operative societies that offer loans to their members out of the pool of savings that are built up by the members themselves. This is a descriptive definition that does not refer to the purpose of credit unions. However, it does describe them as being co-operatives, therefore co-operative principles could be inferred as being the purpose of credit unions. The unique ownership status implicit in this definition (member run, owned and used) led to them being described by Croteau (1963) as being the purest form of co-operative. Not only are trading transactions restricted to members⁴, restrictions are also placed on the membership by requiring that members belong to a common bond. This common bond or interest is usually multiple, associational, occupational or residential. The requirement to belong to a common bond is seen as a corner stone in the success of these usually high-risk credit co-operatives, as the social pressure that is created by the members knowing each other, lessens the risk of default.

Many researchers have examined the role and purpose of credit unions in an attempt to determine their overall objective. The results of these studies suggest that many variant objective functions exist⁵. Difficulties noted by researchers in determining an overall objective function included their unique ownership structure⁶ and their differing co-operative principles⁷.

⁴ If members become non-members then limited transactions are allowed to occur with those persons.

⁵ Overstreet and Rubin (1991).

⁶ Moody and Fite (1971), Flannery (1974)

⁷ Diverse principles were identified by Overstreet and Rubin (1991) and included the provision of low cost credit and high-yielding deposits, building financial stability, and serving an open membership with financial services.

It became evident that researchers could be classified into two differing schools of thought. Those who linked credit union objective function to following some form of classical based economic model⁸. These researchers were influenced by studies done by Robotka (1947) and Phillips (1953) linking co-operative functioning, to economic relationships between the co-operative and its members.

The other researchers suggest that the classic co-operative principles underlie the key objectives of credit unions using some form of member benefit measurement to explain the behaviour of credit unions⁹. Ferguson and McKillop (1997) outline credit unions' main objective as being the promotion of thrift that is directed at fulfilling human and social needs. Stating that credit unions are not formed to make profits, rather to maximise the benefit to their members (self-help). The benefit gained by members not being restricted to financial gain but also including other social factors such as finance education for members. The differing views on credit union objective functions should benefit from an analysis of how credit union principles fit within the overall co-operative movement principles throughout their emergence and development into the current internationally accepted principles adopted by the International Co-operative Alliance in 1995.

To do this the history and development of the co-operative movement is summarised, identifying the key emerging events and discussing the main links that exist between theoretical credit union objectives and co-operative principles that are in existence.

COOPERATIVES

⁸ Classical cost minimisation models were suggested by Taylor (1971, 1977, 1979), Spencer (1996)

⁹ Member benefit objective models were referred to by Croteau (1966), Taylor (1979), Walker and Chandler (1977), Smith, Cargill and Meyer (1981).

The term cooperative may seem to be self-explanatory, however, is open to variant definitions. The thesaurus function in Microsoft word (1997) actually provides twenty-seven suggestions as replacements for the word cooperative. These include: combining, coactive, in league, agreeing, coefficient, joining, conjoint, synergetic, symbiotic, shared, collective, common, mutual, joint, bilateral, trilateral, multilateral, helpful, sociable, companionable, useful, commune, kibbutz, organisation, society, collective and co-op.

The result of this variant interpretation is that the use of the word cooperative to describe a type of business organisation is guided by legislation in most countries. Even with this clarity, much interpretation as to the definition of a cooperative is evident, a priori.

Fairburn (1994) describes co-operatives by contrasting them to other types of organisation, stating that 'cooperatives are owned by those who use them, not by investors or partners whose interest is to make a profit from them.' This explanation highlights the main difference between co-operative entities and normal profit making entities.

The history of the development of the definition of cooperatives and their principles has been subject to many debates over the last two centuries and provides vital information on the purposes and principles of co-operatives. Early definitions seemed to focus on defining cooperatives using the basis of how they divided their profits.

Holyoake (1879), cited by Fairbairn (1994), strongly emphasised the nature of profits and how they should be distributed as the defining element of a cooperative.

Holyoake uses quotes by John Stewart Mill and the Newcastle-on-Tyne Co-operative

Congress (1873) to consolidate his theory on this interpretation of the definition of cooperatives.

‘It is not cooperation where a few persons join for the purpose of making a profit by which only a portion of them benefit. Cooperation is where the whole of the produce is divided. What is wanted is that whole working class should partake of the profit of labour.’ (John Stewart Mill).

‘Any society should be regarded as a cooperative which divided profits with labour, or trade, or both.’ (Newcastle-on Tyne Cooperative congress, 1873)

These views echoed by Holyoake highlighted the principle of equitable distribution to all those who helped to generate them, including consumers and employees, not in terms of capital returns as is normal in commercial companies.

Another definition provided by Mladentaz (1933), cited by Ferguson and McKillop (1997) describes cooperatives as:

‘associations of persons, small producers or consumers, who have come together voluntarily to achieve some common purpose by a reciprocal exchange of services through a collective economic enterprise working at their common risk and with resources to which all contribute.’

This definition does not refer to profits evidencing a change in focus of function from maximising financial gains to achieving a common purpose, which may not be financial in nature. It is more of a description of the structure of a cooperative with an explanation of its purpose. It could be surmised that in the space of sixty years the definition of a cooperative had changed significantly. To examine the continual changes that have taken place to the definition and principles of cooperation it is important to analyse the factors contributing to the emergence of the cooperative movement.

According to Fairbairn (1994) continual change in the cooperative movement is inevitable 'because cooperatives are a living movement in a changing world.' A recent definition published by the International Co-operative Alliance (1995) described a cooperative as being 'an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise.'¹⁰ The emphasis on non-financial gain has been expanded to include not only financial, but social and cultural needs and aspirations. To fully understand the intended purpose of co-operatives their history is now considered. Many co-operative type movements started and failed. To consider all is not necessary. It was decided to investigate the emergence of the current co-operative principles as agreed on by the International Cooperative Alliance, this brings the starting point to Rochdale in the mid-1800's.

HISTORY OF COOPERATION: KEY MOVEMENTS/EVENTS IDENTIFIED.

Cooperatives usually emerge as self-help entities to combat economic and social inadequacies. The first documented cooperative institution was founded in 1844 in Rochdale, England. Though the first 'successful' cooperative, it was in fact not the first, cooperatives had been in existence in Britain as far back as 1769 when the Fenwick Weavers' Association was formed. However, the Rochdale cooperative has definitely been the most influential, therefore its emergence and development are provided.

¹⁰ Wilkins, 2000

The success of cooperatives in Rochdale is due to many factors including, the volatile economic and social climate at the time of the emergence of the Rochdale cooperative. This volatility was caused by the Industrial Revolution. Prior to the industrial revolution, Rochdale had been a center for the manufacture of flannel using the handloom. The industrial revolution resulted in increased competition as the power loom came into existence, producing more flannel in a faster time scale. In addition, increases in American tariff policies resulted in lost markets. These two events caused the decline of the local flannel industry. The result of this caused the people of the area to suffer from periodic unemployment, low pay and dangerous workplaces. There were no social benefits such as insurance, healthcare or pensions. The common people were dependent on merchants for goods and work. Many of these were unscrupulous, exploiting the helplessness of the poor by selling at high prices, adulterating goods, or trapping the workers with credit agreements. (Fairbairn, 1994). At this time, the government was not democratically elected; therefore the people had no voice to protect themselves. Their answer to these social problems was to form a kind of mutual self-help, one of the first cooperatives.

It was not surprising that Rochdale in particular, was the source of the first successful cooperative. Firstly, the town was well known as a center for cooperative idealism and radical politics. The town had a history of strong support for movements, whose ideals supported raising social standards and rights for the ordinary people. These movements included the trade-union movement (violent strikes were recorded in Rochdale in 1808 and in 1829), Chartism (campaign to obtain the vote for ordinary people) and the Factory Act movement for regulation of industry and the protection of employees. In addition, Rochdale had strong links with the Owenite movement. This

movement was named after Robert Owen, an industrialist who supported the ideal of socialism, trade unionism, social reform and cooperation. To achieve social reform Owen believed that economic and educational improvement was essential for improving social standards.

Secondly, Rochdale had cooperative activity already established. The Rochdale Friendly Cooperative Society had been formed in 1830.

The founding members of the first 'successful' cooperative were a group of 28 individuals, of which 15 were active Owenite socialists, ten were weavers and the others were ex-Chartists and temperance campaigners. (Fairbairn, 1994). This cooperative organisation was called the 'Rochdale Society of Equitable Pioneers'. Most of the founding members had a history in one of the aforementioned movements. Although the economic and social circumstances in Rochdale impacted on the formation of the Rochdale cooperative, according to Fairbairn (1994) it:

‘did not rise spontaneously from need, but were organised consciously by thinkers, activists, and leaders who functioned within a network of ideas and institutions.’

From the outset the overriding concept underlying the purpose of the Rochdale cooperative was that of self-help. The cooperative existed for the benefit of its members and the improvement of their social and household condition. The cooperative was multipurpose and the founders prepared objects to guide how the cooperative should be developed. Firstly, a store would be opened (Toad Lane, 1844), then housing would be undertaken, next cooperative production would provide

employment to the members, from this a utopian cooperative community would evolve. Finally, a temperance hostel would be founded to improve moral standards.

To achieve the objects, monies were required. To obtain cash, members could subscribe for shares, which could be paid for by small weekly amounts. These shares formed the capital of the cooperative. This capital was used to purchase goods at low cost and to sell them to its members at retail price. Any surplus made was to be distributed to the members according to their use of the store after paying the capital providers a small fixed sum, retaining some for the development of the society, retaining 2.5% for the education of the members (introduced in the 1854 changes). Education was of vital importance to the founders of the society. By 1850 the society had a library and unlike most modern cooperatives promoted all forms of education. One professor from Cambridge was invited to give a lecture on astronomy! Therefore, from the outset, it can be concluded that education and raising social deprivation was a key feature of credit union objects.

The laws underlying the working of the cooperative were established under statute. These laws were not in fact new. Their origins could be found in a number of Owenite organisations (namely 'The Rational Sick and Burial Society' and the model rules for cooperatives adopted by the 'Owenite 1832 Cooperative Congress'). The initial laws were lacking and were revised within one year and periodically thereafter. By 1860 the pioneers formulated a list of nine Rochdale Practices.

Although the rules were not original to the Rochdale Society of Equitable Pioneers, they because of the success of the cooperative, have been recognised as the founding

source of current day cooperative principles. The success of the cooperative led to the Rochdalian Principles being exported internationally. By 1870, Germany, France, Italy, Denmark, Norway, Finland, North America and the US all had cooperatives that were formed using the Rochdale Practices as a guide.

At this time also Parliament were considering how to regulate such new organisations. To solve the cooperative issue, in 1846 the Industrial and Provident Society Act contained a clause empowering friendly societies to trade among members and the “frugal investment of the savings of members”. Cooperatives were first fully recognised in the later 1852 Act.

In 1895 the International Cooperative Alliance (ICA) was formed with delegates from many countries including the aforementioned and Russia, Holland, Hungary and Serbia. Defining worldwide cooperative principles became one of the goals of the ICA, however, the process was open to much debate and was not resolved until 1937 when a list of seven international principles were established. These included: open membership; one man one vote; distribution of refunds on a patronage basis; limited interest payments for the use of capital; political and religious neutrality; cash trading and the promotion of education (Taylor, 1971).

The majority of these initial principles are still in existence today, though vary depending on the type of cooperative. In fact, these principles are of such importance to the movement that they formed the backbone of the current list of ‘Cooperative Principles’ which was established by the International Co-operative Alliance in

1966¹¹. The aim of the list is to provide a benchmark against which entities can be compared, to establish whether they are genuine cooperatives or not. The revamped principles included most of those formulated in 1937. The main changes were the emphasis that was placed on the promotion of education and the cash trading principle was dropped. An additional principle called 'Cooperation among cooperatives' was also inserted.

The advantages of belonging/joining a cooperative led to the vast growth in the number and type of cooperative institutions being formed. By as early as 1870 there were over 1,000 in Britain (Fairbairn (1994). Although there are many different types of cooperative, most can be classified into 'purchasing' or 'marketing' entities (Taylor, 1971). They either benefit the members by obtaining economies from bulk buying of goods (purchasing) or, by obtaining savings/advantages that are associated with selling/marketing goods as a larger organisation (marketing).

CREDIT UNIONS AS COOPERATIVE INSTITUTIONS

There is no doubt that credit unions are cooperative financial institutions. Their links to cooperative movement principles are evidenced within their regulatory framework, their trade association rules and from definitions that have been coined by the many researchers who have studied this unique financial institution. The strong link to cooperative ethos can be deduced from the definition coined by Barron in (1992). He defined credit unions as being:

‘constituted as democratic organisations, controlled by their members based on the principle of one member, one vote.’

¹¹ Updated in 1995 (Manchester)

This definition refers directly to one of the original cooperative principles that were first established in 1937: the concept of one member, one vote. Ferguson and McKillop (1997) contrasted credit unions to other similar types of financial institution.

‘They stand in stark contrast to the more dominant form of organisation found in industrial societies that is based on speculative gain of a private or corporate kind.’

These dominant forms of organisation include banks, building societies and other mutuals. Credit unions are not only different to other financial/mutual institutions but are also quite different to the normal type of cooperative. They collect savings from members by issuing shares, and use these funds to make loans to the members. Therefore, the credit union not only acts as a ‘purchasing’ but also as a ‘marketing’ cooperative. The main difference between credit unions and other cooperatives is that cooperatives either purchase from external entities for the members, or sell to external entities for the members, whereas the users, management and benefactors of credit unions can only be its members. All transactions are effected for members by members, no external party can transact with the credit union (unless members become non-qualifying then restrictions are placed on the transactions that can occur with that body). It is for this reason that Croteau (1963) described credit unions as being the purest form of cooperative.

The Rochdalian self-help principles have formed the cornerstone to the emergence and development of the credit union movement worldwide. Being cooperative entities, credit unions do not exist to make profits rather to maximise the benefit to their members. Croteau (1963) in line with Ferguson and McKillop (1997), described

these main benefits as being the attainment of the economic and social goals of the members. The Owenite philosophy (which followed through to the Rochdale principles) is also used by credit unions to increase the social goals of members. The main vehicle used by credit unions to increase social goals is education/advice on members' financial affairs. The only potentially conflicting principle is the 'open and voluntary membership'. Influences from the Rochdalian principles can be directly related to the objects of GB credit unions as defined by the Credit Union Act (1979), these are:

- 'the promotion of thrift among the members by the accumulation of savings;
- the creation of sources of credit for the benefit of the members at a fair and reasonable rate of interest;
- the use and control of the members' savings for their mutual benefit; and
- the training and education of the members in the wise use of money and in the management of their financial affairs.'

CONCLUSION

The official legal objectives outlined above are consistent with the international cooperative principles. Therefore it can be concluded that in general cooperative philosophies are still the central objects of credit unions. However, overall interpretation of these objects is not as straight forward as it would seem. Four different individual objects may lead to conflict in decision making within credit unions. For example the first object refers to the promotion of thrift among members by the accumulation of savings. It could be interpreted that to achieve this objective members should be encouraged to save and to obtain a reasonable rate of interest on these savings (promotion of thrift). In conflict with this the second objective is to create sources of credit at a fair and reasonable rate. The lower the interest rate charged on credit, the lower the interest allowable on deposits. The achievement of these objectives, or the perception of steps required to achieve the object may differ between credit unions.

Although some research links credit union operations to economic theory, it would seem from an overview that these relationships exist as a secondary objective that is followed in an attempt to achieve the underlying cooperative principles. Therefore it is concluded that in general the credit union movement operates within the concepts of cooperation.

Research into credit union development hints at their being variant objective functions and indeed it could be logically argued that the objective function of credit unions develops as they become more evolved and sophisticated. This can be inferred from the way the movement is progressing in America and Canada, where over the past

five to ten years a number have converted into commercial banks. Prior, to conversion the credit unions operational status would need to have been sufficient to allow bank status, therefore it could be inferred that more normal commercial objective goals are being followed i.e. profit maximisation etc.

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