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Merging into the mainstream? An empirically based discussion of the potential erosion of competitive advantage in a restructured Irish credit union movement

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ABSTRACT

Credit unions are key constituents of the financial services landscape in Ireland. Currently, the movement comprises mostly small-medium, local, autonomous credit unions. Restructuring is viewed as a means to ensuring viability and achieving economies of scale and scope. Debate has focused on the advantages of restructuring without due concern for its negative consequences. We argue that the competitive advantage of community-based credit unions is inextricably linked to their geographical scale and the implications of restructuring for competitive advantage must be considered. Using qualitative data obtained through interviews with borrowers in seventeen community-based credit unions, we construct a typology of factors influencing members' decisions to borrow from credit unions during a time when credit was widely available and marketed aggressively by the conventional banking sector. We conclude that non-bureaucratic, member-centred systems and relational factors tend to outweigh material considerations in members' decisions to borrow from credit unions. Moreover, both sets of factors relate not only to the movement's ethos but also to the 'connectedness' or sense of 'the local' experienced by credit union members. In the context of a restructuring agenda dominated by mergers and amalgamations, there is a need to guard against the erosion of the movement's unique, community-embedded competitive advantage.

1. Introduction

One of the key determinants of the competitive advantage of co-operatives is their member-centred focus (Briscoe and Ward, 2005; Somerville, 2007; Spear, 2000). Proximity to members, geographically and socially, has been identified as one of the key factors that facilitate the close affinity between members and their co-operatives (Ayadi, Llewellyn, Schmidt, Arbak, & de Groen, 2010; Byrne, McCarthy, Ward, & McMurtry, 2012; Jussila, Byrne, & Tuominen, 2012; Tuominen, Tuominen, & Jussila, 2013; Tuominen, Tuominen, Tuominen, & Jussila, 2013). The challenge for co-operatives of protecting their member-centred source of competitive advantage, while pursuing growth strategies that will enable them to thrive in a 21st-century context, has become a key focus for debate in the literature (Jussila, Tuominen, & Saksa, 2008; Tuominen, Tuominen, & Jussila, 2013; Tuominen, Tuominen, Tuominen, & Jussila, 2013; Uski, Jussila, & Saksa, 2007).

The credit union movement in Ireland is an example of a consumer co-operative sector that recently has come under increasing pressure to restructure, especially since the banking crisis of 2008 and the consequent regulatory reforms. From its origins in the late 1950s as a self-help mechanism to combat financial exclusion, over the past half-century the credit union movement has moved from the margins to the mainstream of the financial services sector in Ireland, enjoying a membership rate estimated at 65 per cent of the Republic's population (ILCU, 2013).[4] Integration into the mainstream, however, brings new challenges for the credit union movement. These include the need to remain

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[4] This penetration rate compares favourably even with countries that have longer-established credit union movements, such as the US, Canada and Australia (McKillop, Goth, & Hyndman, 2006). Widespread membership of credit unions is partly a legacy of the Catholic Church's advocacy of the movement in the 1960s, which helped it to earn public confidence (O'Connor, McCarthy, & Ward, 2002).

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competitive *vis-à-vis* conventional financial service providers and the obligation to comply with increasingly stringent legislation and State regulation to ensure financial stability and guarantee the security and protection of members' assets. The former creates the need to offer a wider range of products and services and to develop service delivery channels; the latter emphasises the need to implement more rigorous procedures, manage risk, and achieve operational efficiencies and economies of scale and scope. Restructuring in the form of mergers has been proposed as a mechanism to facilitate the movement in meeting these challenges (Commission on Credit Unions, 2012). Indeed, this has been the dominant trend observed in longer-established, 'progressive' credit union movements internationally (Ferguson & McKillop, 1997). However, this construction of the notion of progress may not be compatible with the co-operative ethos or the needs and wishes of members. While the case for restructuring carries some validity, there is a risk that the movement may be carried off course on this tide of 'progress'. Moreover, mergers threaten to weaken one of the key sources of competitive advantage of credit unions in Ireland – their connection and affinity with their local communities.

This paper develops a deeper understanding of competitive advantage in community-based credit unions. It does this by using a qualitative methodology to examine the reasons why Irish credit union members prefer to borrow from credit unions over other financial institutions. To date, methodologies employed in studies on the relationship between consumer co-operatives and their members, and the role of local affinity in this, have tended to focus on the views and experiences of management, elected officers and other individuals with 'expert' knowledge (e.g. Jussila, Kotonen, & Tuominen, 2007; Tuomimen, Jussila, & Saksa, 2006; Tuominen, Tuominen, & Jussila, 2013; Tuominen, Tuominen, Tuominen, & Jussila, 2013). While these perspectives are critical to developing an understanding of the relational dimension of co-operative advantage, equally important is the need to explore these issues with 'ordinary' members. In the context of restructuring in the Irish credit union sector, a starting point has been provided by Byrne et al. (2012), whose study of 'ordinary' members provides empirical support for the contention that "members value their relationship with the credit union and are not willing to trade its local nature for increased services" (Byrne et al., 2012, p. 39). In this paper, we build on this emergent strand of the literature. We adopt a qualitative methodology that focuses on members' experiences, creating a narrative that provides further support for the contention that 'local connectedness' is a key factor contributing to credit unions' competitive advantage. This methodological approach contributes a new dimension to the literature on restructuring and its implications for competitive advantage. We argue that competitive advantage may be eroded by efficiency-driven restructuring programmes that may weaken this 'connectedness'.

The paper begins with an outline of the context for the restructuring agenda in the credit union movement in the Republic of Ireland, highlighting the risks posed to competitive advantage. It then proceeds to conceptualise the relationship between credit unions and their members, drawing on the co-operative literature but also on the literature related to consumer behaviour and financial services. Our findings regarding members' reasons for choosing credit unions as a credit provider are then presented and discussed in the context of this literature.

2. Restructuring: a stabilising or destabilising strategy?

Currently, the credit union movement in the Republic of Ireland comprises almost 400 small-to-medium sized, autonomous credit unions, catering for a total membership of 2.98 million (ILCU, 2013).[5] Critics of this fragmented structure argue that smaller/weaker credit unions need to amalgamate with, or transfer engagements to, bigger/stronger credit unions to create viable entities. The case for restructuring gained momentum in the context of the economic crisis that unfolded in 2008. The role of the banking sector in contributing to the crisis focused attention on the need for more rigorous regulation of financial services. In particular, the institutions responsible for bailing out the Irish economy (the International Monetary Fund (IMF), the European Central Bank (ECB) and the European Commission – collectively known as 'the Troika') demanded more robust regulatory frameworks for all financial institutions, including credit unions, irrespective of the their role in the economic downturn. The implementation of measures to comply with regulation results in escalating costs for credit unions. Simultaneously, high liquidity requirements and lending restrictions constrain their ability to generate income at a time when loan arrears and losses on investments are also negatively affecting performance (Gilleece, 2012, p. 56). The increasing cost of compliance with new regulation has been identified as a factor that reduces the viability of small banking organisations (Ferri & Pesce, 2012), thereby supporting the case for mergers.

The rationale for mergers is probably also influenced by the notion that national credit union movements progress through different stages. Proponents of this notion contend that mature stage movements inevitably comprise a smaller number of larger credit unions with enhanced capacity to deliver a diversified range of services in an economically efficient way. Ferguson and McKillop (1997) have been to the forefront of this debate. Based on their observations of the credit union movement internationally, they have categorised credit union movements as nascent, transitional and mature. In addition to the restructuring outlined above, some of the key changes that occur as a movement matures include a greater emphasis on efficiency, well developed central services, professionalisation of service, loosening of the common bond and increased competition. Ferguson and McKillop's (1997) theory embodies an inevitability that credit union movements must 'progress' through each stage of development.

The Commission on Credit Unions (2012), which was established by the Irish government in 2011 to make recommendations on the future development of the movement,[6] places Ireland's credit union movement in the transitional phase of Ferguson and McKillop's (1997) typology. In its report, the Commission, which was chaired by McKillop, advocated restructuring as a key mechanism to facilitate the movement in meeting key challenges. Adopting the recommendations of the Commission's report, legislation enacted in 2012 provided for the establishment of a restructuring board to oversee the "voluntary, incentivised and time-bound" restructuring of credit unions.[7] Hence, restructuring is now firmly on the agenda.

If credit unions wish to compete with mainstream financial services providers and achieve efficiency of operations, then restructuring may be inevitable. What should not be inevitable is the format that restructuring takes (Byrne and the ILCU Rationalisation Committee, 2006; Byrne et al., 2012). The process of reconciling the social mission of credit unions with economic reality creates

[5] This figure includes not just community credit unions, but also occupational and industrial common bonds. It should be noted that many individuals are members of more than one credit union; for example, it is possible to be a member of the credit union in the community where one resides, and also where one works. Therefore, the figure of 2.98 million is slightly inflated.

[6] The Commission on Credit Unions was established to advise government on the future development of the credit union movement in Ireland. Its recommendations particularly focused on the strengthening of the regulatory framework for credit unions and the revision of legislation.

[7] The Credit Union Restructuring Board is commonly known as ReBo.