

## SUSTAINABLE GROWTH OF THE FINANCIAL SECTOR: THE CASE OF CREDIT UNIONS

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**Abstract.** A possible sustainable growth of the financial sector due to the development of activity of credit unions is being examined in this paper. Moreover the analysis of contemporary credit unions conceptions and problems of management improvement are performed. In addition theoretical priorities for credibility and international capabilities of credit unions are presented. A sketch of some actual theories is being performed and methods for analysis of credit unions' activities are particularly composed. Following method of improvement of observational research was performed in this paper. In order to evaluate common tendencies of activities of the credit unions in the World and particularly in the European Union the financial institutions' legal regulations are specially surveyed. Furthermore legal regulations of credit unions are analyzed in practice for local and international credit unions of Lithuania. The preliminary evaluation of the credit unions activity in the circumstances of contemporary waves of the financial crisis is presented. After examining available and possible theoretical and practical aspects the assumptions from the analyzed material are proposed. The article discusses the development of credit unions and the factors affecting the credit union managers approach to the credit union system development prospects. Despite an occurrence of the recent commercial banks global situation concerning the possible disappointment of consumers - credit unions are one of the best institutions for further financial sustainability in the retail credit markets. An object of this research is credit unions and some other self-credit institutions. In addition the accumulated global information from the cooperative financial institutions is overviewed.

**Keywords:** Financial Sector, Credibility, Credit Unions, Development.

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### 1. Introduction

Credit unions, banks and credit co-operative banks play an important role in the national economy and provide millions of its members to benefit from services in the European Union as well as in many other countries around the World in different continents. Cooperative financial institutions operate alongside the traditional banking system - especially in the sector for small personal loans, savings and personal services. They focused on a specific market segment - usually in the middle or lower middle-income people with small and medium-sized businesses. Co-operative financial system has made a significant contri-

bution to the economic sustainable development of many countries. Furthermore these institutions are making the active circulation in the level of thousand billion of Euro equivalent.

Internationalization of the credit union activities is inspired from greatly intensified international economic relations practice. These days credit unions are much more exposed to international business and goods and services are exported and imported worldwide. Different cultures have different interests and priorities that respond differently to doubtful advertising and marketing techniques. During the process of rapid global (and particularly European)

integration the businesses are forced to think about integration into the international markets (McIntyre 2002). Taking some discourse it could be necessary to mention that Lithuania's mainly Western type capital market institutions are quite good integrated into the international organizations. Nevertheless some distrust of financial institutions has been caused by the global financial system recent crisis. Moreover this is a quite sensitive issue for credit unions. Credit unions as a part of the global financial system are almost entirely related on a trust of the people (i.e., the union members) acting in the local and in many cases in the international markets. Therefore credit unions can intensify their competitiveness and ensure the continued existence of financial intermediary businesses. Therefore could be worthy to examine activities of the internationalization of credit unions to find out whether the credit union's group action dominate the «logic of exchange of entities». The significant research on credit union development has been done by McCarthy(2004), Di Salvo (2003), McKillop (2006). Lithuanian credit unions particularly were analyzed by McCarthy (2004), Igarytė (2006), McCarthy (2004) and some other very few authors.

**The problem.** In order to understand why some financial markets researchers have turned their attention on the analysis of credit unions it could be necessary to examine differences between commercial banks management with some level of internationalization and the credit unions management with possible internationalization direction. Besides the sustainable growth of credible financial institutions always is a part of country's economical and national security. Moreover this particularly could be important for the sustainable development of cooperative financial institutions such as credit unions. Especially, due to the lack of investigation in this subject in Lithuania's case.

**The object of this research** is credit unions development and a possible internationalization advance.

**The aim of research** is to investigate credit unions growth with internationalization possibilities and to provide thoughts for the faster credit union development.

**The tasks of research** – to evaluate the management experience of credit unions and to overview improvements in these financial institutions with a possible internationalization accent based on literature, statistical analysis, empirical studies and strategic solutions for credit unions improvement.

**The methods of research in this paper.** In order to provide argument for credit unions to ensure their development (with a special emphasis on Lithuania's cooperative credit institutions) concerning a possible internationalization this paper was carried out using quantitative and qualitative methods (the systematic empirical investigation of credit unions via statistical, mathematical techniques, scientific literature and document analysis, interviews) and the results of a comparative analysis of the study.

## **2. Credit Union's Concept and Its Role in Today's Economy**

This section of the paper shows the modern concept of credit union operations and characteristics described in today's credit union business development issues. However the credit union management and operations for the possible internationalization could be theoretical priorities. Excessively a short summary of the credit unions' chronicle is presented.

Variety of sources in financial literature offers different credit union definitions but given all the mixture of credit union concept brings the same unified characteristics of credit unions. Literature on credit unions generally describes them as a co-operative financial institution providing financial services to a certain group of people connected by common membership criteria.

Meanwhile the majority of this study was done on the basis of nowadays credit unions experience. Moreover the majority of the data was assembled from the Lithuania's credit unions legal regulations and practical experience. Lithuania's credit union is defined by law as a credit institution that meets its members' needs for economic and social activities, that has a license and can receive deposits and other repayable funds from them and to lend those funds to participants according to the Law on the non-professional market associates. Credit unions are entitled to pursue other statutory financial services according to the Law and assume the associated risks and responsibilities (Lithuania's Law on Credit Unions 1995, Law on the Development of Small and Middle Business of the Republic of Lithuania 1998).

Credit unions activities are based on the fundamental principles of co-operative unions and are in general not-for-profit organizations. Moreover an each member is an owner who has the only one vote. Membership in

credit unions affects organic structure of a particular group of people. Each credit union member must buy shares and become the owner of the credit union.

In some countries, “credit union” concept replaces terms such as co-operative financial institutions, micro-credit or self-help organizations, co-operative banks. European Union countries however often use the term a co-operative bank. In many countries - especially in the Western Europe - credit co-operatives have grown into the large co-operative banks that provide full banking services. Nevertheless their management remains based on the same principle - co-operative banks are owned by co-operative members and governing bodies are elected by the same rule - “one member, one vote.” Credit unions differ from cooperative banks in the one important respect. A credit union - unlike a bank branch - is a separate and autonomous company controlled by its members. Moreover these members are both owners and customers and they are responsible for the company’s progress, growth and profitability. Co-operative banks in their membership are defined sometimes by membership in a particular economical or geographical region. Quite similar the credit union could be a public community partner. Moreover credit unions very often help proprietors and small businesses with a credit to create new jobs. It should be noted that the article analyzes activities of credit unions rather than co-operative banks.

Taking a closer look at the credit unions it could be useful to analyze empirical evidence from the Lithuanian Central Credit Union (LCCU, LCKU in Lithuanian). The LCCU is organized on the basis of co-operative bodies as the corporate credit union. The LCCU institution is established by the law of the Republic of Lithuania. The LCCU operates in accordance with the law on a registered credit institution and it is acting as a co-operative company (Law on the Central Credit Union of the Republic of Lithuania 2000). Central Credit Union operates on the basis of share capital and the credit union’s liquidity and solvency restoration functions.

Lithuanian’s credit unions supervisory authority is the Bank of Lithuania. The supervisory authority of the Republic of Lithuania acts according to:

- the Law on Credit Unions, and;
- the license issued by the credit unions supervision administration;
- the Republic of Lithuania Law on Financial Institutions, and;

– the Bank of Lithuania supervisory regulations (Lithuania's Law on Credit Unions, 1995).

Going back to some historical appearance of financial co-operatives it is necessary to remark that the first institution which was a possible credit union initiator has roots in the nineteenth century. Therefore the business practices that today could be associated with co-operatives, was launched by weavers in Rochdale, England, in 1844. Besides a membership in this, consumers organized co-operatives was free. That co-operative fund had the democratic control and all profits were returned to members. Moreover the education of the members of the co-operative was regarded as a vital issue and is known as the Rochdale principle nowadays. Therefore these co-operatives have formed the basis for the principles on which co-operatives around the world operate to this day. Moreover the overwhelming majority of the credit unions are operating according to these co-operatives rules.

The first cooperative credit society in the world was founded in Heddesdorf, Germany in 1850’s. The Heddesdorf credit union was organized in Bavaria. Even before that some co-operatives for self-help purposes were established. Friedrich Raiffeisen (Friedrich Wilhelm Raiffeisen, 1818–1888) motivated by the misery of the unfortunate part of the population founded the Society for Bread and Grain Supply during the starvation of winter 1847. Raiffeisen conceived of the idea of cooperative self-help during his tenure as the young mayor of Flammersfeld. Furthermore the bread society as well as the mutual aid society was founded in Flammersfeld, in 1849. Therefore the charitable society created in Heddesdorf was the ante-cooperative society based on the principle of cooperative assistance. Later Raiffeisen began to develop district and national associations and the central financial institutions. Besides the first credit union in Lithuania, then called the Savings Lending Company (Taupmenų skolinimosi bendrovė, in Lithuanian) was established in Pabiržė, 1871.

Therefore since the mid of the nineteenth century a member-owned financial co-operative or credits co-operative movement was widely developed in the majority of European Nations as well as in another countries around the world. Since then credit unions have more or less positive trends. Moreover these trends has an increasing magnitude in the beginning of the twenty first century. The following table shows the credit unions member statistics during the years 2005 - 2010.

**Table No 1.** Credit Unions' Global Development Trend in 2005 - 2010.

Year	Number of Countries	Credit Unions Number	Credit Unions ' Dynamics 2005=1	Members	Change in number of members
2005	92	42705	1	157103072	1
2006	96	46367	1,09	172007510	1,09
2007	96	49134	1,06	177383728	1,03
2008	97	53689	1,09	185800237	1,05
2009	97	49330	0,92	183916050	0,99
2010	100	52945	1,07	187986967	1,02

**Source:** Author's Calculations from the International Credit Union System Statistical Report, 2011.

**Table No 2.** The World Credit Unions Accumulated Data in 2001-2010.

Year	Deposits (US \$)	Loans (US \$)	Reserves (US \$)	Assets (US \$)
2001	530.450.127.834	393.588.341.911	60.352.532.307	605.518.296.805
2002	589.219.828.002	424.950.529.304	67.419.839.501	676.049.302.487
2003	656.370.220.745	482.574.187.446	74.674.165.182	758.478.695.455
2004	707.438.184.755	531.418.500.904	82.926.748.099	824.653.392.302
2005	763.819.930.158	612.201.609.601	91.557.493.495	894.454.835.782
2006	904.120.858.300	758.208.659.672	106.825.743.418	1.092.135.905.636
2007	987.861.248.618	847.896.069.374	115.358.461.836	1.181.465.915.014
2008	995.741.235.545	847.058.749.226	115.316.544.867	1.193.811.863.722
2009	1.145.851.168.440	911.752.609.007	119.738.181.488	1.352.608.897.477
2010	1.229.389.373.992	960.089.324.653	131.659.476.972	1.459.605.561.772

**Source:** International Credit Union System Statistical report, 2011.

Therefore it is obvious that the world global credit unions accumulated deposits increased each year since the 2001st. The biggest amount of deposits was accepted in the year 2010. The growth rate was 7.29 percent if compared with the previous year. Moreover the increase in the decade was 2.3 times as compared 2010 to the 2001 (see Table 2).

### 3. Internationalization Theories Applicable to the Credit Union's Business

Internationalization of the activities theoretically is inspired greatly by the intensified international economic relations practice. Many large companies began to intensify their rush to foreign country markets.

All activities of internationalization development theories can be conditionally divided into two major groups - the Uppsala internationalization theory - that was pioneered by Swedish scientists - J. Johansen,

F. Wiedersheim-Paul, J. E. Vahlne and the operational stages theory of the internationalization process of innovation and factor theory studies, that are represented by the United States of America scientists - W. J. Bilkey, G. Tesar, M. R. Czinkot, S.T. Cavusgil, S. D. Reid and others (Figueira-de-Lemos *et al.* 2011).

Economic decisions based on the approach to traditional internationalization theories and models of internationalization, which is maximizing the specific economic aspects (Andersson *et al.* 2004, Berkema *et al.* 1998, Calof 1993,1994, Liesch 1999, Manolova 2002):

– Internationalization and the internationalization of the number of transactions cost theory is understood as dependent on economic decisions, how credit unions making strategic decisions in international business - chosen markets, access to them ways out business. These theories is that the credit union, the

choice between alternatives, based on rational economic criteria such as cost, risk and control, gives the internationalization decisions;

– Resource-based theory explains the internationalization of the credit union's strategic decisions, which depend on the capabilities and components resulting from a controlled to certain resources, such as general human capital, management know-how, manufacturing know-how and access to financial capital.

Evolutionary behavioral approaches to the internationalization stage theory known as the process theory says that the credit union is a gradual process of internationalization. There are two stages of the theories of these schools:

– Uppsala internationalization model (U-model), argues that internationalization is a long and gradual process, some credit unions are becoming more aware of foreign markets and, thereby, increasing its resources in order to increase the degree of foreign involvement;

– Innovation-based internationalization model (I-model) shows the credit union operations internationalization stages. Uppsala and the main difference between the models is that the internationalization of innovation-based model explains the internationalization of the credit union as a result of managerial innovation in which each stage of the innovation. Operational level I-model is based on the export share in total sales figures, which may influence the credit union involvement in international activity.

The network model of internationalization of markets is used to analyze the relationship between the credit union networks. The main causes of these networks are that credit unions need extensive knowledge about each other to work together. Typically, such knowledge is dispersed, and credit unions need to be in long-term relationships in order to absorb this knowledge (Alimienė *et al.* 2004). That could be characterized by the increasing internationalization of the credit union and the geographic extent of involvement in foreign activities. There is a wide-reaching internationalization based on these interpretations. Perhaps the most popular concept of internationalization is the Uppsala model, explaining the market-oriented operations in the establishment of forms and techniques.

#### **4. Aspects of Credit Unions Sustainable Development**

Summarizing credit unions operations in international markets could be appropriate to overview theoretical research on the development of credit union performance. Mutual aid is beneficial for a credit union sustainable growth as well as for the responsibility for credit union members. Credit union strength and success depend on the credit union members intentions to pursue common goals, share experiences and work together. A lot of that happens at the level of individual credit unions. Besides a united system of organizations is working to facilitate processes of credit unions from the local to an international level. Analyzing the credit union system trends in various foreign countries, the researchers (Ferguson *et al.* 2002, McCarthy *et al.* 2001) generally distinguishes three stages of credit union and other cooperative financial institution systems development; The credit unions in the level of development; Transitional period; Mature credit union system (Ferguson, McKillop). On the other hand there is an another approach; Credit unions in the formation stage; The national credit union system phase; International credit union system phase (MacPherson). Besides the existence of credit unions in the first or second level of development does not guarantee the transition to the next level of development; it can only be ensured by the consistent development of integration processes in the system.

Moreover the development of a credit union analysis suggests that further development of the network of credit unions associated with the credit union services with the development of new technologies, risk management, strengthening their network stability and liquidity. Following the development of credit unions, there is an evident dependence on sociological - economic factors (Dudzevičiūtė 2006). The data study revealed that about 96 percent of the variation in the credit unions' number has a direct correlation with the average wage trends in the Lithuanian economy, with the GDP per capita figure and the rate of foreign banks share in the banks' system total capital. This analysis suggests that the banking sector privatization have had the direct impact on the credit union network increase.

## 5. Empirical Evidence from Credit Unions in Lithuania

This section presents a short overview of the empirical research on Lithuanian credit unions. Objective of this part is to analyze the Lithuanian credit unions with international management practices and to examine whether the credit union operations internationalization dominated the logical system of international practice and resources exchange of entities. The main revealed obstacles could be a limited membership in a credit union by territorial, professional and citizenship status, occasional international exchanges of information on products, services and management good practice. An analysis of publications and credit unions' web sites provided really useful information. Lithuania had the Central Credit Union and 68 credit unions in more than 114 thousand members in 2011. Lithuanian credit unions members share capital increased the each following year since 2005 (see Table 3). It occurred despite the global financial crisis that has an extremely negative impact on Lithuania's economy in 2009 (the country's GDP decreased by more than 17 percent).

**Table No 3.** Members Share Accumulated Capital in Lithuania's Credit Unions in 2005-2010.

Year	Members share capital (in million Litass)	Members share capital (in million Euros )	Change over the previous year
2005	31.3	9.07	1
2006	46.6	13.5	1.49
2007	67.9	19.67	1.46
2008	92.5	26.79	1.36
2009	108	31.28	1.17
2010	135.8	39.33	1.26

**Source:** Author's calculations

Credit unions share capital increased by 54.82 percent in 2005. Moreover credit union members share capital increased by 48.86 percent, in the following year. The member share capital of credit unions increased by nearly 46 percent, in 2007. In 2008, credit union share capital increased by 36.23 percent. Just because of the impact of the global financial crisis credit union share capital increased only by 16.76 percent, in 2009. However in 2010 the credit union share capital increased by 25.74 percent. Nevertheless the global financial crisis showed its impact on Lithuania's credit unions in the

terms of accumulated profits (see Table 4).

**Table No 4.** The Accumulated Profit of Lithuania's Credit Unions in 2005-2010.

Year	The Accumulated Profit (in million Litass)	The Accumulated Profit (in million Euros)	Change over the previous year
2005	1.7	0.49	1
2006	2.3	0.67	1.35
2007	2.7	0.78	1.17
2008	0.7	0.2	0.26
2009	-5.3	-1.53	-7.57
2010	-5.4	-1.56	1.02

**Source:** Author's Calculations

Fifty three credit unions were profitable but ten credit unions have experienced financial losses and the one credit union had expenses equal to its earned income in 2005. The accumulated profits for the all credit unions of Lithuania was 1,692.3 thousand Litass. This result was higher than 907.5 thousand Litass in 2004 and the highest figure since 1995. Profit growth was influenced by the increase in credit union activity. Fifty eight credit unions earned a profit, eight credit unions have suffered losses in 2006. Total profit reached 2,272.7 thousand Litass for the all credit unions. It was 35 percent more than in 2005. Furthermore fifty nine credit unions earned a profit and eight credit unions experienced a loss. Totally credit accumulated 2,722.4 thousand Litass in 2007. Nonetheless forty seven credit unions were profitable and twenty suffered a loss in the eve of the recent financial crisis. Totally credit unions earned only 0.7 million Litass in 2008. Unfortunately the credit unions had 5.3 million Litass accumulated losses in 2009. As a sign of some recovery thirty seven credit unions were profitable and thirty one had losses in 2010. Entirely the credit unions had 5.4 million Litass losses in this year.

Valuating Lithuania's credit unions internationalization the following realities also can be an indicator for the international cooperation issues. Lithuanian credit unions represented by the Lithuanian Central Credit Union (hereinafter - LCCU), actively participates in the activities of international rights. Moreover the LCCU has a membership in the following international organizations: Proxfin organization; European Association of Cooperative Banks; MasterCard Inter-

national. (Proxfin is an international network of thirty community finance institutions and Développement international Desjardins (DID) whose members have made a commitment to work towards the dual objectives of financial performance and social impact which they consider inseparable (Proxfin, 2012). European Association of Cooperative Banks (hereinafter - EACB) EACB unites all members of Europe's biggest co-operative banks whose assets represent about 20 percent of the retail banking market in Europe. MasterCard International or "MasterCard's" is one of the world's largest consumer credit card payment system operator based in New York).

Meanwhile Lithuanian emigrants abroad also established their credit unions since the mid of twentieth century. It could be mentioned that the Lithuanian credit unions exist around the world. Lithuanians established credit unions in their largest colonies - the United States (Lithuanian Credit Union in Los Angeles (since 1962), Lithuanian credit union "Taupa" in Cleveland, Lithuanian Federal Credit Union "Taupa" in Boston (since 1981), the California Lithuanian Credit Union in Santa Monica (since 1969), Canada - Montreal Lithuanian credit Union "Litas", Lithuanian credit cooperative "Parama" ("Support") in Toronto (since 1952), Lithuanian credit cooperative "Talka" Hamilton, Canada (operates since 1955), "Prisikėlimas" ("The Resurrection") credit cooperative in Toronto, Lithuanian credit union "Talka" in Melbourne, Australia).

## 6. Conclusions

During the process of the accelerating European Union integration distrust in financial institutions is a quite overcritical issue. This uncertainty has a tendency to increase rapidly because of the recent financial system crisis. Therefore credit unions could be one of the main participants increasing the sustainable development of financial institutions especially in the retail market segment. Moreover credit unions had to think about integration into the international markets. Sometime it could be necessary to solve problems offering strategic decisions in the internationalization of credit unions activities. Furthermore the internationalization of the credit union activities can help in the restoration of the trust in financial institutions and - even more important - to increase the number of its members.

On the other hand credit unions should estimate in-

dividual needs of a consumer (and a market) and do not always apply the same standardization strategy as other credit institutions in gaining the competitive advantage in global markets. Therefore the internationalization of activities of the credit unions could help to achieve a required result. Thus necessary policies and procedures can help to organize and monitor their activities and to ensure smooth and safe operations. Moreover credit unions must comply with the laws and requirements of the provisions of the credit union in order to help implement good business practice and experience.

In addition results from the analysis of credit unions' legal regulation in Lithuania uncover that different amendments to the Law on credit unions is a permanent dimension. Significant event in Lithuania's credit union system development is the adoption of the Law on the Central Credit Union and the Law on deposit insurance. Besides the adoption of the Law on Financial institutions has very little influence for credit union operations in practice. However the credit union sustainable development trends and prospects are rarely analyzed in contemporary scientific publications. Therefore more detailed studies are lacking in the credit union development prospects and forecasts. Since the mid of nineteenth century credits co-operative movement was widely developed in the majority of nations around the world. Still then credit unions demonstrate quite positive trends. Furthermore these trends have an increasing ratio in the twenty first century.

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