Credit unions and community in Ireland: Towards optimising the principle of social responsibility

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Abstract

In Ireland, credit unions appeal to a broad socio-economic spectrum and have become integrated into the mainstream financial services market. As many credit unions seek to provide services comparable to conventional banking institutions, they risk eroding their distinctive co-operative ethos. A key differentiating characteristic of credit unions is concern for community and social responsibility. In a business climate where many consumers question the societal and/or environmental impact of businesses, credit unions enjoy a distinct competitive advantage. Despite this, the role of credit unions in promoting societal wellbeing has received limited attention in academic literature. In order to capitalise on its unique competitive advantage, and fulfil its objective of social responsibility, the credit union movement must develop approaches to optimising and assessing how it impacts on communities. Based on research conducted in 40 credit unions, this paper explores the key benefits accruing to communities through intentional and incidental societal impacts. It offers some suggestions for the range of instruments that credit unions can use to optimise the principle of social responsibility. It argues that the impact of credit unions on their communities cannot be left to chance but requires management through the identification and definition of social goals and through periodic assessment of the credit union's success in meeting its targets.

Key words

Credit Unions, Community, Ireland, Social Responsibility

Introduction

Since its emergence in the 1950s as a means of providing credit to those marginalised by the conventional banking sector, the credit union movement in Ireland has experienced significant growth. Today, there are approximately 600 credit unions on the island of Ireland, of which 504 are affiliated to the Irish League of Credit Unions (ILCU). The majority are community-based.[1] Credit unions affiliated to the ILCU have 2.95 million members.[2] Almost €12 billion are held in members' shares and members' loans are €6.8 billion (ILCU, 2010). In terms of membership, credit unions are the largest and most successful co-operative sector in Ireland. They have attracted members from across the socio-economic spectrum and have become a popular 'banking' choice for the middle-classes (Douthwaite, 1996; McCarthy et al., 2000; Corr, 2006; Byrne et al., 2010). Because of their widespread appeal, gradually, they have become integrated into the mainstream financial services sector, operating in the same market as conventional financial institutions. However, an ability to demonstrate and highlight the distinctiveness of credit unions *vis-à-vis* conventional financial institutions will be a key determinant of the future of credit unions in Ireland:

> "*Irish credit unions have not done enough to show that they are not merely a subset of the posse of conventional financial institutions... Creating a greater sense among members of the unique value of credit unions to the community will differentiate them from commercial financial institutions and will play a role in sustaining credit union growth and development*"
>
> (McCarthy et al., 2000, p.125).

More than a decade after McCarthy et al. made this statement, it has renewed relevance, particularly in the context of the damage done to Ireland's economy by a banking sector that engaged in reckless lending. Credit unions must view this period of change in the financial services sector as an opportunity to secure their future by reaffirming their distinctiveness – that they are member-owned financial co-operatives and, thus, the interests of members are paramount – and exploiting this unique competitive advantage.

One of the key factors that distinguish credit unions from conventional financial institutions is their member-oriented ethos. In this context, social responsibility is a core operating principle of the credit union movement and, therefore, it is important to develop a deeper understanding of the societal impact of credit unions. The operating principle of social responsibility states:

> *Continuing the ideals and beliefs of co-operative pioneers, credit unions seek to bring about human*

> *and social development. Their vision of social justice extends both to the individual members* ***and to the larger community in which they work and reside*** *[emphasis added]. The credit union ideal is to extend service to all who need and can use it. Every person is either a member or a potential member and appropriately part of the credit union sphere of interest and concern*
>
> (www.creditunion.ie)

The concept of corporate social responsibility (CSR) and the related concept of social auditing or reporting have received considerable attention in academic literature (e.g. Gray et al., 1997; McAlister and Ferrell, 2002; Garriga and Mele, 2004; Windsor, 2006; Uski et al., 2007; see Mayo, 2011 on CSR in co-operative organisations). CSR can incorporate multiple dimensions, including service to members/clients, development of staff and management and the impact of business on the wider community and the environment. Based on the perception that a growing number of consumers are concerned with ethical behaviour in business, many leading companies have embraced the concept of corporate social responsibility (Mohr et al., 2001; Nicholls, 2002).

Companies that "act in society's best interests often find that they are also serving their own interests" (Johnston, 2006, p.32). In the context of credit unions, "their own interests" equate with the interests of the community because members of the community own the credit union. While credit unions must be economically sustainable, their principal motivation is not to generate profit but to provide a socially responsible financial service to members and the communities within which they operate. Profits are redistributed locally to members and their wider communities. This contrasts with conventional financial institutions, where the financial interests of shareholders and customers are somewhat conflicted. While social responsibility is optional for most businesses, for credit unions it is an integral component of the movement's philosophy.

Despite the scale of the credit union movement in Ireland, both in terms of membership and assets held, the social impact of credit unions on their communities has never been adequately assessed. Based on a study of 40 credit unions, this paper explores the nature of linkages between credit unions and their local communities, specifically in the context of their impact on society at local level. This impact is considered in terms of collective social impact and purposive engagement with the community development agenda (through community groups, schools and youth activities, and support to local enterprise). The study enhances and deepens our knowledge of relationships between credit unions and their communities. The research was conducted when the Republic of Ireland was still enjoying phenomenal levels of economic prosperity. However, this prosperity was fuelled by the financial services sector which, in a 'light-touch' regulatory environment, aggressively marketed a range of credit facilities. Ultimately, this proved unsustainable and led to crisis in the banking sector. The response to this crisis was to impose increasingly strict regulation on the financial services sector, including credit unions, which are now obliged to hold more funds in reserve to ensure that they are adequately capitalised. This is likely to constrain their ability to provide loans and also to contribute financially to community groups and projects.

In the current recession, when public spending is curtailed and the need for investment in communities is even greater, it is important to understand the ways in which credit unions impact on their communities so that limited resources can be deployed more strategically for local benefit. Moreover, this knowledge can facilitate the credit union movement in developing its competitive advantage in the market while actively upholding its principle of social responsibility.

The paper begins by providing a general overview of the results of research conducted in 40 credit unions on the island of Ireland. These credit unions ranged in size from very small (the smallest having just 500 members and the next smallest having 1,915) to relatively large in the context of the Irish credit union movement (the largest having 26,458 members) (Table 1). In each of the credit unions, semi-structured interviews were conducted with five staff members, five board members and five committee members. In addition, a key witness within each credit union was interviewed to allow the construction of a profile of each credit union's interaction with its local community. Each credit union was assigned a number to protect its identity in the reporting of results. The paper describes how credit unions have become deeply integrated into their communities and how they impact upon and engage with their communities.

Table 1. Size of credit unions studied

Membership size category	No. of credit unions	% of sample
>20,000	5	12.5%
15,000 – 19,999	4	10.0%
10,000 – 14,999	9	22.5%
5,000 – 9,999	13	32.5%
500 – 4,999	9	22.5%

Towards an understanding of the social impact of credit unions

Credit unions have "deep and abiding connections to the communities in which they exist... and, as social institutions, they usually recognize a responsibility to enhance the lives of those who live within them" (MacPherson, 1999, p.xii).

The social impact of credit unions can be conceptualised in terms of exclusive and non-exclusive benefits. Exclusive benefits are those which accrue exclusively to members, i.e. loans, savings and other financial services. However, the operating principle of social responsibility recognises that all members of a community are potential members of the credit union. Therefore, if a credit union is to adhere fully to this principle, there is an onus on it to work towards the betterment of society within its common bond. This results in the extension of their sphere of influence beyond that of their members, i.e. non-exclusive impacts. Non-exclusive impacts can be incidental – financial wellbeing of individuals contributes to the economic and social wellbeing of their communities – or purposive – practical support and donations to schools and community groups, support for local enterprise initiatives.

The collective impact of credit union services

> *[When] "whole communities have limited access to financial products the process becomes self-reinforcing and an important contributor to social exclusion more generally"*
>
> (Kempson and Whyley, 1999, p.202).

Credit unions have been significant in combating financial exclusion in Ireland, liberating individuals from the grip of moneylenders and encouraging a savings habit (Byrne et al., 2005; 2007; Corr, 2006; Douthwaite, 1996). Their provision of affordable finance to individuals within the community creates a significant collective community impact. By encouraging and facilitating greater personal control over money management, and by increasing the purchasing power of members, credit unions play an important role in promoting individual dignity, self-esteem, and social inclusion within local communities. Because individuals' eligibility for membership of a community-based credit union depends on having some attachment to that community, they are members not only of the credit union but also of the community in which that credit union operates. Consequently, any support that improves the circumstances of individuals in turn benefits the community collectively. As expressed by one volunteer in this study, the credit union "encourages equality of opportunity, thereby increasing harmony within the community" (Committee member, c.u. no.15).

A commonly expressed belief among interviewees was that credit unions are the only means by which some individuals in the community can access legal and affordable credit. As emphasised by one board member of an urban-based credit union, if the credit union closed, "lower income members would be at the mercy of loan-sharks" (Board member, c.u. no.13). A board member from another credit union emphasised the role of the credit union in providing a financial service in "an area where moneylenders were rife, where money management was unheard of . . . [and where the credit union] has instilled prudence and thrift" (Board member, c.u. no.18).

Participating credit unions reported a range of strategies and instruments employed to promote thrift, budgeting, and effective money management by members. These ranged from publicity campaigns and educational seminars to one-to-one advice and referral for debt counselling. For those experiencing financial difficulties, advice on budgeting, the operation of budget accounts, credit plans and bill-paying facilities, all constitute important aspects of the credit union's objective to promote financial capability (Byrne et al., 2010). Credit union policy also promotes good money management: instead of withdrawing from their savings, members are encouraged to borrow within their means and continue saving while repaying their loan.

The services credit unions provide are especially important in the context of cost-rationalisation strategies employed by banking and other services (Byrne et al., 2004). Sokol (2007) emphasises the growing spatial and 'relational' distance between banks and their customers (e.g. low levels of trust, lack of understanding and poor knowledge of personal circumstances) that arises from rationalisation of branch networks and the transition to automated delivery channels (ATMs, online and telephone banking). In contrast, credit unions maintain a permanent presence in their communities. In addition to providing a personal financial service locally, credit unions also offer services such as bill payment facilities, foreign exchange, and international money transfer.

Purposive engagement with the community development agenda

The principle of social responsibility, derived from the more general co-operative principle of concern for community, is operationalised by credit unions

through their engagement with other institutions and groups within the local community. This often takes the form of sponsorship and donations, and 'in-kind' supports, such as the provision of meeting rooms or other facilities for community groups. Credit unions also have a role in educating their members and the wider community about money management. Some credit unions have also initiated, or become involved in, enterprise and employment creation strategies (McCarthy et al., 2000; McCarthy, 2011). All of these supports represent direct or purposive engagement with the community development agenda.

(i) Support for local community groups

Credit unions represent an important source of sponsorship for local organisations dedicated to specific social and community development goals. In our study, all 40 credit unions reported making financial contributions to a range of groups and events, including Gaelic games clubs, youth clubs, retirement clubs, People of the Year Competitions, Tidy Towns projects, and local festivals. The value of sponsorship and donations varied significantly among credit unions but an estimated total of €721,295 was contributed by these 40 credit unions to local community groups annually. Assuming a similar rate of investment by credit unions not included in our survey, this would suggest that the combined total annual investment by all community-based credit unions exceeds €8.7 million annually. To a large extent, the selection of projects for sponsorship is based on requests for support from community organisations and, in this context, the approach could be regarded as being more reactive than proactive.

As well as financial support, credit unions provide a range of other practical supports to community groups. One-third of credit unions provided office facilities, such as fax and photocopier, while one-quarter allowed their meeting rooms to be used by local groups. Most significantly, half of all credit unions in the sample identified staff time as a form of support given to community groups. This ranged from knowledge-based supports, such as the provision of speakers to educate local groups about money matters, to skills-based services, such as maintenance of local websites. Other services to the community included the operation of summer job schemes, charity collection boxes, and community noticeboards.

Active engagement with other community development and voluntary organisations can help credit unions to maximise their community impact. A majority (62.5 per cent) of credit unions reported that they were participating in joint ventures or partnerships with other organisations at the time the study was conducted. Their objectives were primarily economic (e.g. low-rent units for local enterprises) and social/civic (citizenship awards, enhancement of local environment, regeneration and restoration projects, youth and senior citizen groups, local housing co-operatives, community centres, community radio service).

Credit unions can play an important role in promoting voluntary service in their local communities. One credit union, for example, organised an annual 'Voluntary Committee of the Year' awards ceremony to recognise the efforts of voluntary groups and to raise their profile in the community. Recognition was awarded in four different categories – community development, charity organisations, sports, and arts and culture – and a special award was made to the overall winner. This type of initiative can foster the voluntary ethos at community level.

(ii) Interaction with schools

Credit unions are acutely aware of the importance of schools as places from which future volunteers and board members can be recruited (McCarthy et al., 1999). Furthermore, raising the profile of the credit union movement among young people is an important mechanism for promoting financial prudence among future generations. Focused on these objectives, credit unions affiliated to the ILCU participate in co-ordinated initiatives which seek to encourage talent and raise the profile of the movement among this segment of the population. These include an annual All Ireland Schools Quiz for primary schools and a poster competition for children and teenagers. In our study, 93 per cent of credit unions surveyed provided some form of donations or sponsorship to local schools. This commonly involved sponsorship of school football teams, talent competitions, grants for computers and other facilities, student bursaries and school book rental schemes. Credit unions also provide opportunities for work experience, educational talks and school visits. These activities forge strong and important links between schools and credit unions, and alert students to the existence of organisations outside the school that work for the greater good of the community. Students also learn that, by working with community-based organisations, they can "feel and believe that they have some control over their situations in the sense of having ability to influence intentionally what happens to them and their community" (Costello, 1984, p.115).

School credit unions can provide an appropriate vehicle for developing good money management techniques from an early age. Furthermore, they provide useful experience to students involved in

running the credit union and promote a voluntary ethos. In our study, 45 per cent of credit unions were involved in operating school credit unions. There are mutual benefits for credit unions and schools in the relationships that have developed. Schools gain materially (e.g. donations of computers), academically (sponsorship of debating competitions, school tours), artistically (sponsorship of poster competitions, school choirs) and socially (financial support for school teams and sports days which help to address issues of childhood obesity and physical fitness). The credit unions benefit by gaining access to a potential pool of members and volunteers and, therefore, it could be argued that, as well as supporting and educating the youth of the community, they are also investing in their own futures.

(iii) Supporting local enterprise

Access to low cost, flexible credit is one of the main requirements of micro enterprises. Business lending remains an area that is underdeveloped within the Irish credit union movement. This can be attributed to a lack of expertise within credit unions in relation to assessing loan applications, anxiety about lending large amounts, and factors that make credit unions less attractive vis-à-vis other credit providers, in particular, relatively short repayment schedules and high interest rates, which contribute to limited demand (McCarthy et al., 2000). While credit unions in Ireland often do not provide 'business loans' *per se*, they do consider applications for personal loans for business purposes. Indeed, because of their potential to support local enterprise and stimulate job creation, business loans are a recognised component of the social finance model, which seeks a social dividend as well as a financial return on loans (ILCU, 2005). Despite the limitations outlined above, therefore, the most common mechanism by which credit unions in this study supported local businesses was in the form of loans for business purposes, which were granted by 85 per cent of credit unions in the sample. The current credit crunch means that entrepreneurs are experiencing significant difficulties in accessing credit. If credit unions are to develop this area of business, they will need to ensure that they are equipped with the skills and expertise that will allow them to make prudent decisions (Financial Regulator, 2007). In this regard, one suggestion has been that professional associations and Chambers of Commerce would encourage their members to become volunteers in their local credit unions (Stewart, 2010).

Apart from micro business loans, other direct supports to local enterprise include grants or donations, which are made available to community enterprises for the purposes of job creation by 50 per cent of the credit unions in our study. Twenty-five per cent of credit unions surveyed also provided assistance to local enterprises in the form of office facilities, such as fax and photocopier and 23 per cent provided meeting rooms. This type of support, while very basic, can be highly significant for entrepreneurs who otherwise would have to incur expensive room hire charges and who would find the cost of office facilities prohibitive. Business advice and training were provided by a further 23 per cent of credit unions. These included referrals to local enterprise boards or other business advisory agencies.

Six credit unions (15 per cent) were proactively engaged in local economic development through their involvement in the establishment of enterprise centres. While it is important to respond positively to approaches from individual local businesses, credit unions must also recognise their potential to contribute in a more proactive way to local economic development, particularly in the current economic recession. Co-operation with other local institutions is a key mechanism through which this can be achieved. The potential role of credit unions in developing local economies is illustrated by one example from the West of Ireland, a region which, traditionally, has struggled to attract significant industrial investment. In co-operation with the local Chamber of Commerce, the Town Council and the local Community Development organisation, the credit union was involved in setting up an Area Community Development project. The principal aim of this initiative was to stimulate local job creation. The strategy included the development of an enterprise centre to accommodate mature businesses and to incubate new enterprises. This involved the provision of grant aid, advancing loans to the project company and to some of the new enterprises. The credit union is also involved in the operation and direction of the company.

Other examples of proactive credit union initiatives included the setting-up of a special enterprise loans fund, operated in conjunction with a local development partnership company, which provided seed capital at nominal interest rates for small local enterprises. Another credit union led a successful campaign to secure a tenant for a vacant factory unit and also set up a website to promote its town, especially for tourism. Therefore, the influence of credit unions on their communities extends beyond the voluntary community sector and schools and into the business world. Notwithstanding problems in relation to the ability of credit unions to offer business loans, by providing

vital support to small local businesses – many of which mainstream financial institutions are unwilling to assist – credit unions support the local economy by creating and sustaining employment. This in turn has social benefits for the community.

Optimising the credit union difference

The current banking crisis, which has been experienced particularly acutely in Ireland, has led to widespread disillusionment and mistrust of conventional banks (Edelman, 2011). While the crisis is raising increasing concerns about the stability of the credit union movement in Ireland, previous studies have found credit unions to enjoy a higher level of trust than banks; members have regarded credit unions as trustworthy institutions where members' interests are paramount (Amarach, 2009; Power et al., 2011). Moreover, internationally, it has been observed that, despite the global financial crisis, co-operative credit institutions have remained financially sound, continue to enjoy a high level of trust and, as a result, are attracting large volumes of new customers (Birchall and Ketilson, 2009). Credit unions now have an opportunity to capitalise on this favourable reputation as socially responsible financial service providers. The empirical findings of this study illustrate the means by which credit unions can exercise a positive societal impact. While this provides a starting point for credit unions aiming to identify and define their social goals, in order to fully operationalise the principle of social responsibility credit unions need to continually improve their understanding of the ways in which they actually do, and potentially can, improve their local communities.

The process of social auditing or social reporting facilitates organisations in optimising the principle of social responsibility by allowing them to evaluate the impact of their activities on stakeholders – customers/clients/members, suppliers, staff and the wider society and environment. Within the credit union movement, a social audit can facilitate the development of strategic direction by helping each credit union to define its purpose and to develop a better understanding of its members, its community and the organisation itself (Brown, 2000). This in turn can help it to enlarge its appeal to potential members and can form an important component of its growth strategy.

Our study suggests that credit unions that have a formal community impact policy perform better in terms of financial contributions to community projects and initiatives. Although they are guided by co-operative principles, there is no uniform policy to direct how credit unions fulfil their social responsibilities. Only 40 per cent of credit unions (16 out of 40) reported that they had a formal written policy to guide how they impact on their communities. Of the thirteen credit unions that contributed most to community development projects, nine had in place formal community impact policies to guide their investments in the community. Conversely, of the 17 credit unions that contributed least to community development initiatives, fourteen did not have a community development policy.

While not advocating the formulation of policies that are so rigid that they cannot respond to changing needs within the community, it is apparent that the process of examining existing practices, exploring and defining social objectives, and periodically measuring the extent to which these objectives are fulfilled, offers potential for helping credit unions to uphold the principle of social responsibility in a meaningful way.

Because credit unions are run by voluntary Boards of Management, their financial and economic affairs have been particularly closely regulated by the state, even before the advent of more rigorous regulation of the conventional financial services sector. However, credit unions, arguably, have paid less attention to their social obligations. Because of the symbiotic relationship that credit unions have with their communities, it is important that they put in place strategies for managing their interaction with their communities in order to fully exploit the opportunities offered by the current economic downturn. The traditional *ad hoc* approach to engaging with community needs to be addressed. Given the central role that credit unions now play in the lives of their communities, a more structured approach to this issue could yield significant dividends for the wider credit union movement and for society. In the current context of austerity in exchequer spending, people can no longer rely on the state to provide many of the facilities and services required for the economic and social wellbeing of their communities. Ironically, community members seeking to improve their localities will be forced to raise money locally at a time when households are suffering the effects of economic recession. If credit unions are to maximise their contribution to community development, they will need to become more strategic in their deployment of resources.

As a mechanism for developing strategic direction and ensuring inclusive decision-making, one possibility could be a standardised social report (with a significant degree of flexibility built in) conducted by individual credit unions, with support and leadership from key

representative organisations (in Ireland, the ILCU and the Credit Union Development Association – CUDA). The provision of a template for social reporting is one way of facilitating the interrelated objectives of optimising social responsibility and marketing the credit union difference.

Conclusion

This paper has outlined some of the ways that credit unions impact positively on their communities. By virtue of their very existence, credit unions contribute to economic and social wellbeing within communities by promoting financial and social inclusion, boosting the local economy, and providing important services. Furthermore, they are engaged with the community development agenda through their involvement with community groups, schools and youth activities, and local enterprise initiatives.

It is acknowledged that conventional financial institutions perform many of the economic and social functions discussed here. However, for banks and other financial service providers, the maintenance of service provision within local communities and the way in which these services are delivered are determined by the primary goal of profit maximisation. Furthermore, sponsorship of community projects is undertaken primarily as part of public relations strategies that aim to enhance market profile. In contrast, for credit unions the social dimension is of equal importance to economic considerations.

The 'credit union difference' derives from their not-for-profit, social orientation. Credit unions are embedded in the social, economic and cultural fabric of their communities, and this embeddedness is reinforced by the concept of the common bond. Instead of having customers, credit unions have members, and this suggests a sense of belonging and ownership that cannot be replicated by conventional banks. Credit unions are run by members of the community for members of the community. These are some of the distinguishing features of credit unions and, as such, represent a key source of competitive advantage. The challenge, however, remains for the credit union movement to promote and exploit its distinctive competitive advantage in a more coherent and organised fashion. This is a process that needs to be managed carefully if credit unions are to contribute to their communities in a more meaningful way, particularly in the context of economic recession. Through research, reflection, policy formulation, and marketing, credit unions can do more to optimise the principle of social responsibility. This in turn can support the mutually reinforcing objectives of social responsibility and sustainable growth.

Notes

1. Approximately 475 credit unions are community-based. The remainder are classified as industrial or vocational (e.g. teachers, musicians, health care providers).
2. 2.95 millions members is equivalent to approximately 50% of the combined population of the Republic of Ireland and Northern Ireland. However, as some people hold membership of a number of credit unions, the membership figure of 2.95 million is slightly inflated.

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Measuring board performance in a credit union

Ted O'Sullivan

Abstract

This paper begins with an introduction to the issue of measuring board performance in a credit union in the Irish context. A discussion on the responsibilities of the board of directors is followed by consideration of how board performance might be measured. Measurement criteria are identified from the literature. A methodology is identified to test the use of these criteria in the Irish credit union context. The results are presented and followed by a discussion.

Key words

Board of Directors, Credit Union, Key Result Area, Key Result Areas, PEARLS, Performance Measurement, Self-assessment, Supervisory Committee

Introduction

The success or failure of a financial institution is directly related to the performance of its board of directors. This has never been more obvious than in today's economic climate where meltdown of financial institutions has become commonplace, frequently occurring as a direct result of failures of their boards of directors. An inability or unwillingness to measure board performance in an objective and critical manner is often at the source of this failure. Ten years in advance of this global banking collapse, the Irish credit union movement had moved to incorporate measurement of board performance into its legislation, requiring, through the Credit Union Act 1997, that periodic reviews of board performance be conducted.

The six hundred credit unions in Ireland are member owned, not for profit, co-operatives. These credit unions have almost 3 million members out of a population of approximately 5 million. This level of market penetration is remarkable and is, in fact, the highest in the world. McKillop *et al* (2006:388) describe the Irish credit union movement as an *undoubted success story*. This high success level results in a corresponding high dependence on credit unions by the Irish for access to credit and financial services. Failure to strictly assess and monitor the performance of the board of directors of credit unions would, then, have disastrous consequences for its membership and, therefore, for the people of Ireland.

In spite of the requirement for measurement of board performance enshrined in the 1997 Credit Union Act, the methods by which this measurement might be achieved are not suggested. This paper aims to address this problem by exploring means by which assessment and measurement of board performance in credit unions might be satisfactorily conducted.

Responsibilities of the board of directors

Much has been written on the responsibilities of the board of directors with the general thrust of the literature suggesting that a good board of directors results in a good enterprise. Garratt (2003) states emphatically that:

> "*An organisation's success or failure depends on the performance of its board* "
>
> (Garratt, 2003: xix)

Yet, while there is general agreement by researchers on the importance of board performance, accord on a common definition of the role of the board is more elusive. Authors differ considerably in their views on what constitutes the actual role of the board with each placing emphasis on different areas. Parnell (1999) sees the role of the board as primarily one of directing the organisation:

> "*...providing the overall guidance and control necessary to keep an enterprise on the path determined by its purpose and objectives.*"
>
> (Parnell, 1999:131)

Garratt (2003) suggests that the role is one of oversight using the analogy of the helicopter to explain his premise:

> "*The board sits at the intersection of the organizational effectiveness and efficiency cycles as the center of the business brain, taking a helicopter view of policy and strategy issues.*"
>
> (Garratt, 2003:35)

Cropp (2005) focuses on the leadership role of the board stating that:

"*Directors should use their position as leaders to ensure that the co-operative remains focused on its vision, purpose, core values, and performance. Boards have a responsibility for understanding the co-operative's business as well as the external environment in which the business operates.*"

(Cropp, 2005:1)

The fact that each of these definitions, in spite of the differences in emphasis between them, is valid in itself highlights the problem that exists for anyone attempting evaluation of board performance.

How to measure the performance of the board of directors?

In an open, market driven economy the standard by which a board's performance is measured is by the principle of **capital market efficiency**. If markets are efficient, then share prices fully reflect the performance of the company, i.e. the board. However, the recent history of companies such as Enron etc., where share values were subject to manipulation, demonstrates that this theory is far from perfect as a measure of board performance.

Since measuring board performance, then, is a problem even in companies that have a quoted share price, what then of the co-operative or enterprise that does not have a tradable share? Again, authors differ widely in their approach to this dilemma. While the literature universally recognises that evaluating the performance of boards of directors is a good thing, a problem arises when seeking a method by which this can be done. Leblanc (2005) recognises that measurement is absent and even doubts the possibility of ever arriving at a model of measurement stating emphatically

"*The measurability of governance? It's not measurable.*"

(Leblanc, 2005:27)

Significantly, however, he succeeds in identifying the absence of board analysis as the missing link which would allow for such a measurement. Chavez (2002) takes a more positive view urging a coherent review of the management structure and personnel:

"*Management evaluation should include a review of salaried managers, officers, committees, and members of the board of directors.*"

(Chavez in Branch and Klaehn, 2002:263)

Parnell (1999), in turn, echoes the opinion of Chavez but goes a step further in the process and proposes a quantifiable method of assessing the performance of the board of a non-profit enterprise or co-operative:

"*Depending on the nature of the co-operative business, it will be possible to identify certain key result areas (KRAs) that are absolutely critical to the success of the enterprise.*"

(Parnell, 1999:141)

The initial identification and subsequent examination of these key result areas should prove invaluable in helping to establish a successful measurement of board performance.

Key result areas (KRAs)

Identification of KRAs suitable for use in performance assessment of boards may be achieved in a number of different ways. One of these is through examination of the experiences of some unsuccessful enterprises. In the world of medicine, many discoveries derive from *post mortem* examinations with findings informing the development of new and more effective procedures for better future outcomes. In a similar way, the application of the *post mortem* method to a business failure, as suggested by Cahill (1997), should not only reveal valuable information on the reasons for that failure but should point to a methodology for earlier diagnosis and, therefore, remedial treatment of serious problems. As Oscar Wilde so elegantly points out:

"*Experience is the name everyone gives to their mistakes.*"

(Wilde, 1892: Lady Windermere's fan, Act III)

In the world of business, an analysis of the experiences of others can prevent repetition of their mistakes and can help to identify the qualities necessary for a successful enterprise. Wilcox (2007) clearly recognises this when he asserts:

"*We believe studying poor financial institutional performance is a superb way to enlighten readers about the qualities of safe and sound credit unions.*"

(Wilcox, 2007:1)

Inevitably, a failed business may be examined and dissected with more clarity and objectivity than a temporary setback in a surviving organisation. Such a failure is defined by Cahill (1997) as follows:

"*Economic failure occurs when the organisation is unable to earn sufficient profits to enable it to*

service its capital structure with an appropriate market rate of return"

(Cahill, 1997:5)

But Cahill not only defines economic failure, he indicates a means of measuring this failure when he states:

"*Managerial failure reflects the top management and board of directors' poor performance when benchmarked against others in the same industry*"

(Cahill, 1997:5)

This concept of benchmarking against other institutions in the same industry, considered critical by Cahill, provides another important measure of board performance.

Wilcox (2007), in his analysis, concentrates on the area of ratios which he considers a key indicator of performance. He specifies:

"*The following variables were found to be statistically associated with failures of credit unions and commercial banks alike:*

- *Higher ratios (to assets) of net loans, commercial and industrial loans, provision for loan losses, delinquent loans, and non-interest expenses*
- *Lower ratios of capital and return on assets*"

(Wilcox, 2007:6)

The significance of the relationship between ratios and financial performance assessment is well documented.

"*Depending on the nature of the co-operative business, it will be possible to identify certain key result areas (KRAs) that are absolutely critical to the success of the enterprise*"

(Parnell, 1999:141)

Parnell (1999) is clearly of the opinion that KRAs exist for all co-operatives and that these depend on the nature of the business. He states that every director must achieve:

"*Full comprehension of financial and control information, including the concepts of liquidity and solvency...*"

(Parnell 1999:116)

Leblanc (2005) also recognises the link between the board's performance and the financial results:

"*It may well be possible to determine a relationship between board effectiveness and corporate financial performance*"

(Leblanc, 2005:152)

The literature confirms, then, that KRAs must be examined as a yardstick of performance and it appears that in the credit union context, ratios provide these KRAs. In credit unions in Ireland, the CAMEL (Capital, Assets, Management, Expenses, Liabilities) ratios were in use until 2003. These ratios were limited by the fact that the M (Management) ratio was never defined and no agreement was possible on what should be included in this section. In 2003, the Irish League of Credit Unions introduced the PEARLS (Protection, Effective financial structure, Asset quality, Rates of return and costs, Liquidity, Signs of growth) financial ratio system, a system developed and tested by the World Council of Credit Unions (WOCCU). Every three months, each credit union must make a prudential return to the Credit Union Regulator with a copy also going to the Irish League of Credit Unions (ILCU). The League returns a report to its member credit unions. This report contains (i) twenty-seven financial ratios for the most recent prudential return together with (ii) the previous ratios for that credit union, (iii) the average value of each ratio for the movement (iv) a goal value established by WOCCU and (v) a commentary by the monitoring branch of the Irish League of Credit Unions.

The information contained in this PEARLS report is critical to an understanding of a credit union's current position and, therefore, of the performance of its board. The findings of the literature review strongly support the view that careful analysis of this report is most important. KRAs in the measurement of a credit union's success are the twenty seven PEARLS ratios. John Hume in his address to the UCC Summer School 2004 put it succinctly when he declared

"Get the numbers right because the numbers will support the philosophy but if the numbers are wrong the philosophy will not support the numbers"

(John Hume, UCC Summer School 2004)

Self-assessment by boards

Lakey and Hofheimer (2004) show that one of the best ways to improve board performance is by self-assessment: the board of directors assesses its own performance:

"*One of the most significant ways in which a board can strengthen its performance as a governing body is to periodically assess its own performance*"

(Lakey and Hofheimer, 2004:4)

This is a simple and inexpensive option available to a board of directors or a supervisory committee of a credit union wishing to measure and improve

performance. The board of directors can step back from its normal humdrum routine and reflect on its overall performance. A more comprehensive self-examination is advocated by Hughes (1999) who shows that:

> "*Boards that regularly engage in forward retreats know that the time spent away from the press of daily responsibilities and tasks can allow the board to challenge assumptions and rethink systems, begin a strategic planning process, tackle difficult issues, forge camaraderie, and improve productivity*"
>
> (Hughes 1999:2)

Such a strategy combined with an examination of the KRAs as suggested above should lead to an honest appraisal of the performance of the board of directors.

Summary of research

In any assessment of the performance of the board of directors of a credit union, the PEARLS ratios fulfil the role of KRAs and the inclusion of the average ratios for the national credit union movement represents the comparison with benchmark companies. When these are combined with board of directors' self assessment of their own performance, we get a useful yardstick for measuring board of directors' performance in Irish credit unions.

Methodology

This paper sought to assess the extent to which the PEARLS ratios and the self-assessment method are being used in measuring board of directors' performance in credit unions in Ireland. In the Credit Union Act (1997), the task of overseeing the performance of the board of directors is reserved to the supervisory committee. Byrne *et al* (2003:9) describe their role succinctly:

> "*The supervisory committee's overall function is to oversee the corporate governance structures in the credit union*"
>
> (Byrne, McCarthy and Ward 2003:9)

Because supervisory committees are required by section 59 of the Credit Union Act (1997) to review the board of directors' performance four times a year, a survey of the supervisory committees of credit unions was undertaken. The supervisory committees were asked about the training done by the board of directors, the use of the PEARLS as KRAs and if self-assessment was being used in their credit union. A questionnaire was administered at the annual conference of National Supervisors' Forum in Ireland (NSF) in November 2008 and one hundred and sixty-two replies were received. The results were entered into the PASW (formerly SPSS) statistical package to facilitate analysis.

Results

The supervisors were asked if the process of assessing the board of directors' performance was a worthwhile exercise. Eighty five percent (85.3%) of respondents said it was worthwhile. The large positive response establishes that the supervisory committees believe in the process and in its merit in the measurement of board of directors' performance.

The next question explored whether the supervisory committee used the KRAs of the PEARLS Ratios in their assessment. The sixty-three percent (63.1%) positive response shows that the importance of these KRAs is grasped by the majority of supervisory committees. But a large minority of thirty-seven percent (36.9%) don't use these KRAs in their assessment of board performance. This is a surprisingly large number when one considers the time and energy that the individual credit union puts into preparing and returning the prudential return, the subsequent work of analysis by the ILCU and the detailed report which is then sent to the member credit union.

To ascertain if boards of directors understand the PEARLS ratios, supervisors were asked how many credit unions had directors who had attended a PEARLS training course. Only twenty-nine percent (29%) of respondents said that directors from their credit union had attended PEARLS training, leaving a large majority of seventy one-percent (71.1%) who had not done so.

The use of the self-assessment by boards of directors was tested by asking if their boards had ever conducted a self – assessment of their own performance. Only seventeen percent (17%) of respondents replied positively suggesting perhaps that this method, though popular in the USA, may not be well known to boards of directors in Ireland.

The questionnaire also requested supervisors to rate the general educational and training commitment of their board of directors on a ten point scale. This resulted in a mean commitment level of 5.3 with a standard deviation of 2.1, suggesting that though there is some commitment to education and training it is not seen as the most important priority. In order to further test this issue, supervisors were asked how many directors had attended training courses in the previous twelve months. This resulted in a mean director attendance rate of 4.16 with a high spread of responses

as the standard deviation was 3.86. This indicates that though some credit unions had a high attendance rate by directors at courses, there were others who had little or even no attendance.

Conclusion

It seems that many credit unions do not give the PEARLS ratios the attention they deserve. The analysis and understanding of the PEARLS ratios as KRAs by sixty-three percent (63.1%) is to be welcomed. There are, however, thirty-seven percent (36.9%) of credit unions who do not use these results to inform assessment of the management decisions of the board of directors.

The mean board size of the credit unions surveyed was twelve (12) and the mean number of directors attending courses per year is four (4) approximately. Therefore, about thirty percent (30%) of credit union directors on average attended courses in the past twelve months. But as the standard deviation is high, the percentage of directors attending courses varies widely from credit union to credit union.

Supervisory committees need to put greater emphasis on the education and training performance of their respective boards of directors, perhaps even including it in their assessment report. One is reminded of Watkins (1986:2) who gives *neglect of education* as one of the principal reasons for the demise of many co-operatives. There is a requirement in the Credit Union Act (1997) on boards of directors to perform a training needs analysis. It is clear that the performance of this function needs to be included in the supervisory committee assessment of board of directors' performance.

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