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What drives the performance of cooperative financial institutions? Evidence for US credit unions

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Abstract

Nested analysis of variance is used to identify the sources of variation in performance, measured by growth of membership and growth of assets, for a large sample of US credit unions. The analysis reveals that sector effects (geographic, common bond and charter type) account for only relatively small proportions of the variation in performance. This raises doubts as to whether credit unions are likely to benefit much from competitive repositioning at sector level (by changing their charter type or common bond designation). It may be that the perceived benefit derived from such manoeuvrings is greater than the actual benefit, or it may be that the large number of credit unions seeking a more permissive operating environment has ended up negating any potential gain in performance across the sector as a whole. In contrast to the limited role identified for sector effects, individual credit union effects explain a large

proportion of the variation in performance. This suggests that decisions made by individual credit unions with respect to staffing, governance and product portfolio, as well as philosophy and ethos, play an important role in explaining the heterogeneity in credit union performance.

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Notes

[1]See Credit Union National Association (2004) for more information on the distinctive features of US credit unions.

[2]Larger credit unions provide a similar array of retail financial services to personal customer as banks and savings and loan associations. In addition, credit unions may also offer interest bearing business checking accounts and commercial loans (to a multiple of 1.75 of a credit union's capital or no more than 12.25%), agricultural loans and venture capital loans. Credit unions may also deal in investment products such as bankers' acceptances, cash forward agreements and reverse purchase transactions. This has brought them into direct competition with mainstream financial services providers. Recent evidence suggests that credit unions play an important role in promoting competition among retail banks in highly concentrated banking markets (Tokle and Tokle, 2000; Feinberg, 2001; Feinberg and Rahman, 2001; Hannan, 2003; Schmid, 2005).

[3]In the period 1998 to 2003, 500 federal credit unions have altered their common bond to that of community.

[4]Federal credit unions are generally exempt from all federal, state and local income or franchise taxes. State chartered credit unions are exempt from federal and most state income taxes.

[5]See for example, Fried et al. (1993, 1994), who utilize data envelopment analysis to compute efficiency measures for US credit unions, and explain differences in relative efficiency in terms of industry effects.

[6]The authors are indebted to Callahan and Associates for supplying most of the data on which this article is based.

[7]These geographical areas have become much wider during recent times. An example is America First, which in 2003 was granted a charter by the NCUA permitting it to serve members in six Utah counties.

[8]Frame et al. (2003) in a study which focuses upon the distribution of the credit union income tax subsidy emphasize the cost-efficiency effect of the common bond. The authors note that credit unions with a residential common bond have higher costs than mutuals but that single common bond occupational and associational credit unions are more cost efficient.

[9]The National Credit Union Share Insurance Fund insures individuals' shares of all federal credit unions and a majority of state credit unions. The remaining state credit unions secure share insurance from various state and private funds.

[10]In 2002 and 2003, a further 13 federal credit unions converted to a state charter, while an additional 51 federal credit unions merged into a state chartered credit union

[11]In 2002 and 2003, a further 35 state credit unions converted to a federal charter, while an additional 54 state credit unions merged into a federally chartered credit union.

[12]Roy Bergengren was a credit union pioneer at the forefront of securing state and federal laws in the United States. He paved the way for the development of credit unions. By 1929, his leadership resulted in the passage of 32 state credit union-related laws. He also led the fight to pass the federal credit union act and was the first executive officer of CUNA & Affiliates and CUNA Mutual. He helped substantially build the foundation of the US national credit union organization and in doing so established the foundation for the worldwide credit union movement. He helped with the drafting of the Federal Credit Union Act 1934, and the Massachusetts Credit Union Act which formed the basis of what became the credit union acts in the US, Canada, UK and Ireland.

13 A number of credit unions have recently converted to mutual savings banks. Merrick (2001) calculates that 16 credit unions have converted since 1995. He argues that although as yet it involves very few credit unions, interest in conversion is symptomatic of the fact that legislative and regulatory events have eroded the value of the credit union charter.

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