“Status and prospects for the development of credit unions in Ukraine”

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STATUS AND PROSPECTS FOR THE DEVELOPMENT OF CREDIT UNIONS IN UKRAINE

Abstract

Credit unions increase social orientation and efficiency of the market economy by providing their members with necessary financial services on a non-profit basis. Unfortunately, the role of credit cooperation is underestimated in Ukraine. The article investigates factors, condition and prospects for the credit unions' development as an important component of Ukrainian economy. Both optimistic and pessimistic scenarios of credit unions' development in Ukraine have been provided based on forecasts involving methods of analytical equalization of dynamic series, correlation and regression analysis and extrapolation. Analysis of the main indicators of credit unions' activity in Ukraine between 2004 and 2016 made it possible to detect that between 2008 (when indicators were the highest) and 2016 there was a downward trend in the number of credit unions (by 41%), membership (by 76%), total assets (by 66.5%), deposit and loan portfolios (by 79 and 68%, respectively) with a relative stability of capital ratio (by 39%). Creating a cooperative cluster which will be able to combine the material, monetary and labor resources of all major types of cooperatives in the country at the regional level has been outlined as one of the means to increase the credit unions competitiveness in Ukraine. Therefore, the purpose of the article is to assess the state and forecast trends in the development of credit unions in Ukraine in order to identify the prospects for their functioning in the future.

Keywords credit cooperation, credit union, forecast, credit, prospects

JEL Classification C59, G21, L30, L31, L39, O16

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INTRODUCTION

The country's economy sustainability depends significantly on the effectiveness of mechanisms allowing the accumulation of temporarily free funds and redistributing them effectively. One such mechanism is credit cooperatives operating in the financial services market along with banks and represented in Ukraine as credit unions.

Being an alternative to commercial banks, credit unions on a non-profit basis promote the competitive environment development in the financial services market of the state's economy and increase the social orientation and efficiency of a market economy. However, in Ukraine, the role of credit co-operation is underestimated, which, in the authors' opinion, actualizes the research topic.

1. RECENT RESEARCH AND PUBLICATIONS ANALYSIS

Different authors in latter half of the 19th and the early twentieth century, namely Antsyferov (1919) and Lurye (1928), investigated theoretical and practical aspects of credit unions and credit cooperation system development. Chayanov (1918) highlighted the theory and practical development of cooperation. Meyer (2012), Myunkner (2001),

and Frenzel (2008) pay attention to the problems of credit cooperation development in the current context. The peculiarities of the development of the cooperative sector in transition economy are examined by Heiets (2003). Goncharenko (2015) considers historical aspect of the credit unions revival and development in modern Ukraine. The author was among the first to develop credit unions organization according to well-defined co-operative principles. Lutsyshyn (2013) investigates the credit unions' role and place at the Ukrainian financial market. Panteleymonenko (2015) considers various aspects of scientific developments to improve the mechanism of credit unions functioning. Pozhar et al. (2013) analyze the non-profit nature of the unions. However, the process of developing credit co-operation in the Ukrainian economy in today's dynamic market environment remains underexplored. First of all, this concerns the definition of the prospects for the development of an effective system of credit co-operation in the Ukraine in the future, which has determined the relevance of the research subject.

The aim of the paper is to assess the status and trend forecasting in credit unions development in Ukraine in order to identify prospects for their future performance.

Main research findings. The processes of the Ukrainian economy's market transformation led to the need for fundamental transformations in all sectors. In general, in our opinion, the process of transformation, foreign economic integration and the preconditions for the current development of credit cooperation in Ukraine presented in the form of credit unions (CUs) can be divided into five stages (Table 1). The division is based on the CUs' growth periods compliance with the phases of life cycle model of economic organizations.

Given the SWOT-analysis results of credit unions' activities in Ukraine (Balaban & Sokolova, 2012, p. 59), the main issues of their effective functioning are: a distinct membership structure; low CU's solvency and profitability; inadequate personnel skill level; lack of the CU's regional associations; there is no system of stabilization and mutual crediting between the CUs; a large number of pseudo-unions that can discredit the credit cooperation concept; weak market position of most CUs; NACUU is too weak financially to eliminate deficiencies and threats by itself, etc. Therefore, we will further analyze these factors in order to identify the regularity and trends to forecast and to determine the prospects for future development.

The analysis of the CU's activity reflects their development in Ukraine; this will also allow identifying sources of increase in their performance. The research is based on the systematization and analysis of CU's activities data for the period of 2004–2016 (The National Commission for State Regulation of Financial Services Markets, 2004–2014; The National Commission for State Regulation of Financial Services Markets, 2016).

The analysis of membership dynamics of CU indicates a constant decrease (Figure 1).

Source: prepared by authors based on (The National Commission for State Regulation of Financial Services Markets, 2004–2014; The National Commission for State Regulation of Financial Services Markets, 2016).

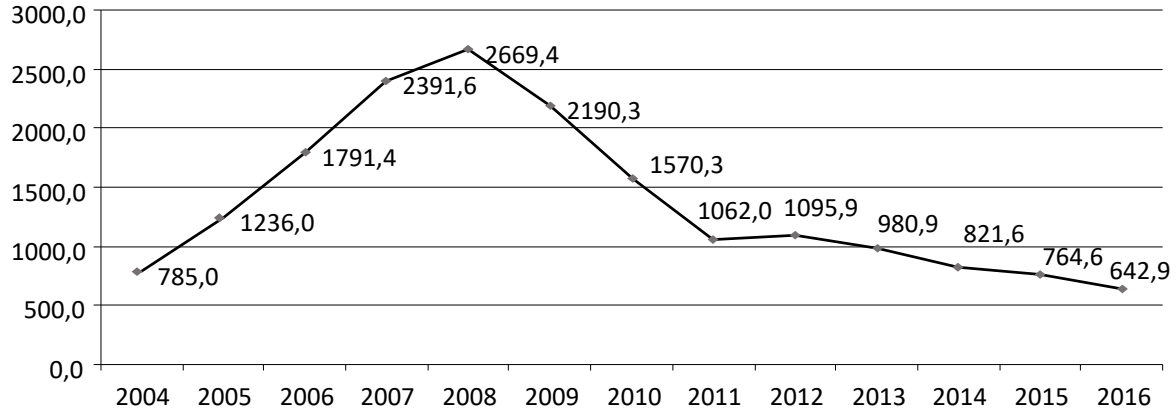

Figure 1. Membership dynamics of CUs for 2004–2016, ths. persons

Table 1. Main stages of credit-cooperation movement transformations in Ukraine in 1991–2016

Source: prepared by authors based on Balaban and Sokolova (2012, p. 42), The National Commission for State Regulation of Financial Services Markets (2017).

Year	Main stages characteristics
	1st stage: 1991–1993 – "Revival of credit cooperation concept and the early formation of a legislative framework for the credit unions performance"
1991	Revival of the credit cooperation idea with the support of the Ukrainian Co-operative Council of Canada and the Canadian Cooperative Association, the initial phase of the Canadian Program for the Credit Unions Development in Ukraine
1992	Establishment of the National Organizing Committee on the CUs development in Ukraine
	Development of the first two CUs "Vygoda" (Stryi city), "Samopomich" (Kryvyi Rih city)
1993	Adoption of the Provisional regulation "On Credit Unions in Ukraine"
	Further development of the CU – 20 units as of January1, 1993
	2nd stage: 1994–2000 – "National Association of Credit Unions of Ukraine (NACUU), credit unions establishment and development"
1994	Development of National Association of Credit Unions of Ukraine (NACUU) by 20 credit unions and NACUU's accession to the World Bank Credit Unions Council
	Selection of model CU (7) to implement the first phase of the Canadian Program for the Credit Unions Development in Ukraine (CPCUDU)
1995	NACUU accession to the World Council of Ukrainian Cooperatives
	Implementation by the Agency for International Development (USA) of the Project for CU's development assistance in Ukraine
1996	The beginning of the second phase of the Canadian Program for the Credit Unions Development in Ukraine, selecting 20 model CU in this regard
1997	Development of 80 modeled unions
1998–1999	Implementation of pilot project "Region" – CPCUDU and NACUU
1999	Measures to implement the Microcredit Program of the CU with the assistance of the International Fund for Social Adaptation (IFAS) and the NACUU
2000	Decree of the President of Ukraine "On Measures for the Development of the Cooperative Movement and Strengthening Its Role in the Reforming the Ukrainian Economy on Market Principles"
	3rd stage: 2001–2005 – "Improvement of the legislative framework of the CU' activities, creating under the Financial Services Commission the Department of CU supervision"
2001	Adopting a framework law for all financial institutions and recognizing a credit union as a financial institution
	Creating a single cooperative center of Ukraine – National Cooperative Alliance
2001	Implementation of the Credit Union Support Program developed by IFAS, NACUU, and George Soros Institute of Open Society
	Introduction of the CU rating assessment
	Introduction of Micro Lending Programs for Small and Medium-Sized Businesses
2001	The "Program for strengthening the CU in Ukraine" implemented by the Canadian International Development Agency
2002	Adopting the special Law of Ukraine "On Credit Unions"
2003	Adopting the Law of Ukraine "On Cooperation"
	Establishment of the Credit Institutions Supervision Department under the Financial Services Commission
	Development of All-Ukraine Association of Credit Unions (AUACU)
2003, 2004	State registration of credit unions in the state register of financial institutions
2004–2005	Credit unions licensing according to their members' contribution to deposit accounts
2003–2005	Prudential supervision over the CU activities by the Credit Institutions Supervision Department
	4th stage: 2006–2008 – "Formation and development of credit co-operation"
2006–2008	Growth of the CU's assets and increased control over the unions' conformity to cooperative principles
	5th stage: 2009 to date – "Crisis"
2009	Resolution of the United Nations' General Assembly on the proclamation of 2012 as the International Year of Co-operation
2009–2011	Significant reduction of the CUs' main financial and economic indicators
	The fundamental change in the structure of the Financial Services Commission and the transition of the latter from the supervision of statutory norms observance to the one based on risk and solvency assessment
2012	The state controller of the CU was renamed the National Commission, which carries out state regulation in the field of financial services markets (the National Financial Services Commission). Its structure changed
2013	Growth of assets and other financial indicators compared to last year
2014	The fundamental changes in the credit co-operation system are due to the adoption of the Tax Code of Ukraine as in force in 2014
2015	The fundamental changes in the credit co-operation system are due to the planned change of the state regulator of the National Financial Services Commission to the NBU
2016	Reforming the state regulation of non-bank financial services markets

Source: prepared by authors based on The National Commission for State Regulation of Financial Services Markets (2004–2014), The National Commission for State Regulation of Financial Services Markets (2016).

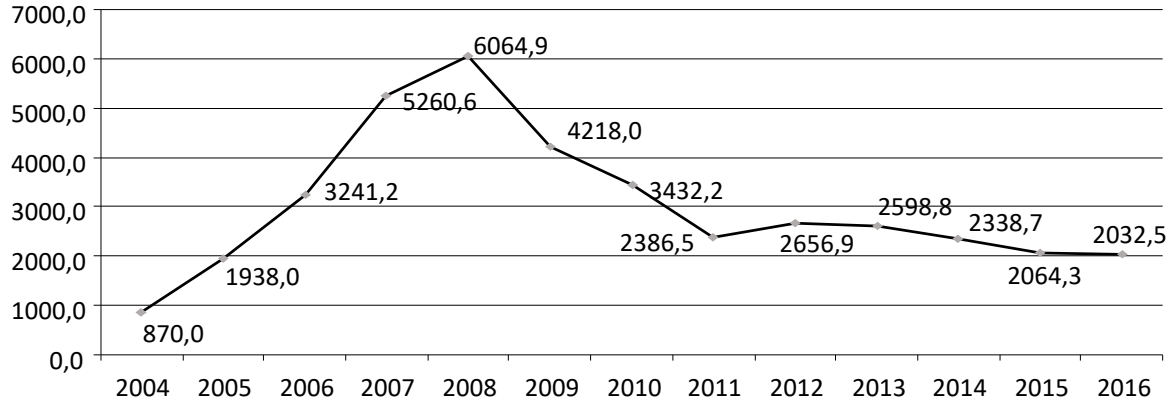

Figure 2. Dynamics of CU's total assets, 2004–2016 (at the end of the period), million UAH

This applies not only to the reduction in number of participants who use CU's credit and deposit services, but also their total number: in the period 2008–2016 alone this figure reduced by 4.2 times (from 2669.4 to 642.9 ths. persons). Credit unions' positions in the financial services market have deteriorated significantly, which is confirmed by statistical data. In particular, the total amount of capital in the period 2008–2016 decreased by UAH 669.6 million or 39%, and the number of credit unions – by 317 units or 41%. At the same time, the decline in the credit unions' number was accompanied by deteriorating financial status and significant drop in solvency and liquidity. According to statistical data on the volume of assets of financial services market participants in Ukraine, since 2010, there was a positive trend. However, this cannot be said about the credit unions segment: the volume of their assets in 2016 decreased to 2032.5 million UAH, which is 66.5% less than the 2008 level (when the index was the highest) (Figure 2).

Analyzing the credit unions' total asset dynamz ics it should be noted that in the future, it will be quite difficult to restore the level of 2008. The sharp decrease in the number of credit unions was mainly due to the reaction of the state regulator to pseudo-unions which discredit international cooperative principles. The state regulator responded as follows: data on insolvent and illiquid credit unions were excluded from the State Registry of Financial Institutions and their registration certificates were cancelled (The National Commission for State Regulation of Financial Services Markets, 2004–2014). Therefore, the 2011 year was critical for the CUs, despite the fact that the comparison of the existing credit unions number with the number of banks confirms that the first have the increasing role in financial services provision.

Competition encourages the actors of any market to develop and improve. However, for the banks, the situation in the Ukrainian financial services market is not favorable, as the growing popularity of credit unions leads to their potential clients loss, which in turn leads to a decrease in projected income, a level of economic and financial security, changes in strategic development plans, etc. (Sahaidachny, 2012).

The global financial and economic crisis in 2008 undoubtedly affected the credit unions' activities, as they did not receive any support from the National Bank of Ukraine or from the government. At that time, credit unions to support liquidity were forced to rely on their members, since the central (single, self-regulated) institution did not exist, and commercial banks did not want to lend. At the same time, the unions primarily worked with risky short-term loans for the population.

The state regulator activity created the necessary conditions for commercial banks to gradually overcome the crisis 2010 effects, and nominal bank deposits reached pre-crisis levels. At the same time, loans and deposits issued by credit unions have declined significantly. Comparison of data shows that in absolute terms, the volume of loans and deposits

Table 2. Forecast of credit unions' main indicators, 2017–2020

Indicators	Dependence type	For actual period 2005–2016, yearly average	2017	2018	2019	2020
Credit unions income, mln. UAH	$y = -13.582 \cdot x + 1001.9$	927,2	838,9	825,3	811,8	798,2
CUs' membership, ths. persons	$y = -129.23 \cdot x + 2291.7$	1580,9	740,9	611,7	482,5	353,3
Assets, mln. UAH	$y = -155.96 \cdot x + 4171.4$	3413,6	2399,9	2243,9	2088,0	1932,0
Capital, mln. UAH	$y = -7.1067 \cdot x + 1144.4$	1105,3	1059,1	1052	1044,9	1037,8
CU member' contributions to deposit accounts, mln. UAH	$y = -115.49 \cdot x + 2781$	2145,8	1395,1	1279,6	1164,1	1048,7

of commercial banks significantly exceeds the relevant indicators of credit unions.

In general, it should be noted that in the saving services offered by credit unions, there has been little positive progress. In 2016, the CUs' share of members that had deposits in deposit accounts amounted to 6.4% (in 2008, this figure was 6.14%; the lowest level of the indicator was recorded in 2012 – 4.1%), and the number of members who had deposits in deposit accounts in 2016 amounted to 41.1 thousand people (in 2008 – 164 thousand people) (Leonov, Oleszczuk, 2014). However, in 2014, the share of credit union member who had deposits in deposit accounts amounted to 4.1%, which is 3.2% less than in 2016, that is, we have recently observed a revival in the unions' financial activities.

The structure of CU's loan portfolio in the period from 2008 to date has not changed much: the share of loan for real estate purchase, construction, repair and reconstruction has moderately increased. As in previous years, in 2016, consumer loans were the most demanded in the market, 58.6 % (UAH 1059,4 million). As part of the consumer loans, loan for purchase of motor vehicles accounted for 3.3 % (UAH 35,0 million), audio equipment, video and household appliances – 3.9 % (UAH 41,4 million), etc. These loans were not popular in many commercial banks due to the complex maintenance process and small income. Credits for the real estate purchase, construction and repair rank second – 20.6 % (UAH 371,8 million). The loans granted to farms, as in previous periods, have the smallest share in the total volume of loans issued, 2.9% (UAH 51,7 million) (The National Commission for State Regulation of Financial Services Markets, 2004–2014; The National Commission for State Regulation of Financial Services Markets, 2016).

Given the efficient credit unions development in Ukraine, consumer loans for small businesses can potentially become cheap and affordable. This is largely due to the fact that according to the Law of Ukraine "On Credit Unions" of December 20, 2001 No. 29-08-III, the credit union has a right to issue loans to private entrepreneurs and farms (Verkhovna Rada of Ukraine, 2017).

To predict the development of credit unions in Ukraine, it is necessary to determine their dependence on the number of members, the size of assets, capital and contributions to deposit accounts based on equalizing the dynamic series for the given indicators (Table 2). This methodology also made it possible to make a forecast of changes in these indicators for the period 2017–2020.

For all the indicators, we have analyzed that in 2005–2016, large oscillation amplitude was characteristic.

For example, in 2008, the income of credit unions amounted to UAH 2 billion, while at the beginning of the mentioned interval it was only about UAH 0.5 billion, and in the end – UAH 0.7 billion. Similar variability is also characteristic of other researched indicators. In addition, since 2008, all indicators have a negative dynamics. The forecast shows that the credit unions' potential accumulated in recent years is still appropriate, but it is gradually being exhausted, and without urgent and radical changes in this sector

Table 3. Consolidated results of the pair correlation of CU's income and the factors affecting it

Pair correlation type	Model type	Model equation	F-test statistic
I/M	Polynomial of 7th degree	$y = -460066,045 + 2135,766 \cdot x - -4,106 \cdot x^2 + 0,0043 \cdot x^3 - 0,0000026 \cdot x^4 + +9,13 \cdot 10^{-10} \cdot x^5 - 1,76 \cdot 10^{-13} \cdot x^6 + 1,42 \cdot 10^{-17} \cdot x^7$	99.5
I/A	Polynomial of 6th degree	$y = 20643,56 - 51,679 \cdot x + 0,048 \cdot x^2 - -0,000022 \cdot x^3 + 5,095 \cdot 10^{-9} \cdot x^4 - -6,022 \cdot 10^{-13} \cdot x^5 + 2,821 \cdot 10^{-17} \cdot x^6$	99.5
I/C	Reversed logarithmic	$y = \frac{1}{0,0069 - 0,00085 \cdot ln\, x}$	99.0
I/D	Geometric	$y = -401,269 \cdot x^{0.000045 \cdot x}$	99.5

Note: pair correlations according to types: I/M – income/CU membership; I/A – income/CU assets; I/C – income/CU capital; I/D – income/depositions to CU deposit accounts.

(even in an optimistic scenario), there will be a slowdown in the development rates and decline of key performance indicators, and if pessimistic scenario – credit unions can practically cease to exist by 2020.

In order to deepen the dynamics analysis, the corr elation-regression method was used and pair correlations were considered. Further analysis enviso aged to define the dependence of credit unions' income on the above factors: their membership, size of credit unions' assets, size of capital, value of CU members' contributions to deposit accounts.

A consolidated analysis of all these factors impact on the credit unions' income indicates a close correlation. In all cases, there is a nonlinear dependence (Table 3).

The next step of the analysis is to find out the pert spective changes in the credit unions', income depending on the factors determining it. All four factors have a positive effect on the unions' income. Calculations made as of 2019 indicate that the credit unions' income will increase depending on the change of factors for one additional unit as follows: almost UAH 12 million, if the credit union's membership will increase by 1 thousand people; for UAH 5.5 million, if assets increase by UAH 1 million; for UAH 0.4 million, if the capital will increase by UAH 1 million; almost UAH 6 million, if contributions to the deposit accounts will increase by UAH 1 million.

Given the positive effect of these factors on int come, the following clarification is necessary. In the dynamics, positive changes were observed only because 2005 year was taken as the base of comparisons. For example, according to the basic growth rate, the income in 2014 was 151.5% from 2005; assets – 120.7%; capital – 156.3% (the credit unions membership and the contributions to deposit accounts, as noted earlier, decreased in the mentioned time interval). Accordingly, the forecast values will also reveal some time increase in indicators against 2005, although the chain growth rate shows that since 2009, the development of credit cooperation has significantly deteriorated. In the forecast series from 2017 to 2020, one can see a decrease in income. Credit unions in 2017 can count on income in the amount of just over UAH 838.9 million, and in 2020 – less than UAH 800 million. The same can be said about the forecast CUs' membership dynamics (741 thousand people in 2017, about 350 thousand people in 2020), assets (UAH 2.4 billion in 2017; UAH 2.0 billion in 2020), capital (about UAH 1060 million in 2017; UAH 1040 million in 2020), deposits on deposit accounts of credit unions' members (UAH 1.4 billion in 2017; UAH 1.0 billion in 2020).

According to Myskiv, Andreykiv, and Rudevska (2016), forecasting of the credit market development during the period 2016–2019 showed that there will be a growing trend in all credit market segments in Ukraine. Nevertheless, the projected growth of bank credit portfolios will be more significant, as compared to non-bank financial institutions. For example, at the beginning of 2019, compared with 2015, it is expected to be 121.5%, despite the projected decline in loans given by non-bank financial institutions in 2016 compared to 2015 – by UAH 31,574,2 million, at the beginning of 2019, one predicts the growth in the volume of lending by non-bank financial institutions up to UAH 38,122,1 million. However, this indicator is still lower than at the beginning of 2015. Thus, the role of the non-banking sector, including credit unions, remains insignificant.

Globalization accompanied by radical changes and shifts in all spheres of public life requires the credit co-operation in Ukraine, new methods of economic activity in order to increase its performance and competitiveness.

It should be noted that nowadays, there are new forms of contemporary alternative type of financial intermediation. For example, P2P projects are a new form of lending. The idea came from the US and now is very popular in the Western countries – this service is now competing with banking lending on equal terms. The peer-to-peer lending, which is fairly widespread internationally, remains a new phenomenon on the domestic financial market. Despite some similarities with the functioning of mutual credit institutions such as credit unions, cooperative banks, savings and loan associations, etc., P2P lending services provide for a clear distinction of the roles of lenders, borrowers and companies' owners, i.e., credit intermediaries (Lavryk, 2016). Thus, the ensuring of economic growth in Ukraine demands the increasing role of non-bank and hybrid forms of lending.

Globalization international integration involves the creation, at the international, national and local level, of elements such as networks, alliances, and clusters. The attractiveness of the clusters lies in the fact that the cluster can combine enterprises of various sectors: finance, production, science, agrarian sector for the integrated implementation of the goals, while maintaining the independence and flexibility of each object.

Clustering through the principles of simultaneous cooperation and competition contributes to the growth of labor productivity by enhancing the specialization and division of labor between enterprises, increasing the volume of information and ideas for the exchange between enterprises, as well as stimulating competition and innovation, reducing unit costs and increasing the member organizations profitability, which is the economic effect of the cluster (Sokolenko, 2002). The positive effect of clusters on business development in the region is due to the providing the enterprises with high-level specialization, incentives to create new firms serving a particular market niche, with a low level of vertical integration within the cluster.

Therefore, in modern economic conditions it is expedient to consider a cluster approach for the credit unions development in Ukraine. The differences between clusters and networks – open membership, social values, and trust between participants, interaction between co-operation and competition, and the complex implementation of tasks (Kozmenko & Roienko, 2016) are similar to the principles of cooperation, which complements the feasibility of combining cooperative enterprises into clusters.

Credit unions are of great socioeconomic importance for the country, however, the difficult financial and economic and social situation of these organizations does not stimulate entrepreneurs to invest in their innovative development. Similar problems are characteristic for the activity of agricultural service (production) cooperatives and consumer cooperatives. Therefore, one way to increase the competitiveness of all cooperatives types in Ukraine is to create a cluster, which at the regional level will be able to combine the material, monetary and labor resources of all types of cooperatives (Balaban & Sokolova, 2012).

The cluster approach to organizing the economic activity of the cooperative sector will unite the efforts of consumer, credit and agricultural cooperation to increase the living standards of the population and revive agricultural industry.

Integrating the three main types of cooperation will be exceptionally advantageous in the creating credit unions and service (production) cooperatives as a part of already existing consumer unions, with their members, resources and ready-made material and technical base. The system of consumer co-operation can act as an integrator of the Ukrainian cooperative sector, since it is the most organized and most widespread one. The following conditions are: an integration idea and integration motives, the benefits of which are combined with the interests, means and resources of all types of cooperation, investments promotion to improve the member service, as well as the availability of financial and labor resources and skilled personnel. Consequently, all of the above conditions for implementing the integration processes of consumer, credit and agricultural cooperation look likely.

Integrating the interests of other types of cooperatives with credit co-operation is very important, because consumer cooperatives are mostly small and medium enterprises that, in a down economy, were outside the Ukrainian financial institutions lending due to the risks caused by the financial instability of Ukoopspilka enterprises, and agricultural cooperatives depend significantly on environmental conditions.

In the authors' opinion, the main problems with the creation of clusters in Ukraine are: lack of knowledge and authorities awareness in the cluster approach application, lack of financial and organizational support for clusters in the country, low level of researches on this issue and lack of staffing, taking into account the specifics of cluster organizations management, etc. (Balaban & Sokolova, 2012).

Thus, using cluster techniques to the Ukrainian credit unions development in the globalized world will increase its role; enhance innovation, solvency, liquidity and profitability of unions, which simultaneously will increase real incomes and public service level.

CONCLUSION

Thus, the credit unions development in Ukraine has been continuing for more than twenty years. Despite the difficulties faced by Ukraine's lending cooperation, it is worth noting the positive results. According to statistics, there were 462 credit unions in Ukraine as of 2016, which united more than 642,9 thousand citizens and had total assets of almost UAH 2032,5 million (The National Commission for State Regulation of Financial Services Markets, 2016).

Micro- and social lending remains the traditional market niche of credit unions. They are mainly focused on providing financial services to low-income categories of people, households, small entrepreneurs and farmers.

The vast majority of borrowers using credit union services are not a priority customer base for banks. Credit unions are designed to help raise the overall level of purchasing power, business activity and employment.

Against the backdrop of a global 2008–2009 financial crisis, it became quite telling that most credit unions, while adhering to generally recognized international cooperative principles, continued to lend to the population, remaining the only source of financial support for thousands of ordinary Ukrainians.

Prospects for the development of credit cooperation in Ukraine largely depend on the government support of credit unions; increasing the efficiency of public administration and control of credit unions; adoption of amendments and additions to the Law of Ukraine "On Credit Unions" and cooperation with other Ukrainian cooperative organizations; state assistance to the long-term lending development; ensuring the credit cooperatives financial stability and solvency; appropriate level of credit unions capitalization, increase in the population's solvency, creating an effective system of organization and management in the credit-co-operative sector of the national economy.

The analysis of the main indicators of Ukrainian credit unions activity testifies to the negative tendency of reducing the number of credit unions, their membership, total assets and other indicators. This indicates the loss of the previously accumulated potential. Therefore, there is an urgent need for revolutionary changes, without which the decline rate in key performance indicators of credit unions will at best be slowed down with the transition to long stagnation (in an optimistic scenario), and in a pessimistic scenario, credit unions will virtually cease to exist in the medium term.

One way to increase credit unions competitiveness in Ukraine is the cooperative cluster development, which at the regional level will be able to combine the material, monetary and labor resources of all types of cooperatives.

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