

**Financial Co-operatives in Quebec, Canada:
A Study of the Desjardins Movement**

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Abstract

The paper is a study of the Desjardins movement – which has had almost a century long existence. While the co-operative structure in Quebec, Canada is very similar to the Indian structure – of three tiers, the pattern of evolution of this structure as been different. The paper discusses how the Desjardins movement has evolved over a period of these one hundred years, how it has faced competition and shaped the policy environment in Quebec.

We examine the role of each of the tiers in the structure and also some salient auxiliary organisations related to the movement. The most important highlight of the movement is the pace at which the movement grew – slowly in the first few decades and fairly rapidly after systems, procedures and norms were laid out. The second highlight is the growth part taken – starting with the caisses and moving up the tiers as and when the necessities arose rather than create a superstructure above ab-initio.

It is also important to look at the tremendous amount of self-regulation they have resorted to – both in terms of internal audit and in terms of building up a security fund in case of difficulty or default. It also highlights the major challenges faced by the movement, particularly with respect to member-retention, member-relations, member-satisfaction and member-patronage of the services. These issues are discussed in the context of automation and computerisation.

In this context, the study suggests that the re-organisation envisaged by the movement has to be done extremely carefully. The paper concludes by listing the learnings for the Indian co-operative movement and for the rural financial structure.

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Introduction

Desjardins is the largest financial service providers in the province of Quebec, and indeed the fifth largest in Canada. It provides a full range of financial services to all its members and has remained in the forefront of using technology while remaining responsive to the members and following the spirit of co-operation. The Desjardins movement is a complex network of legal entities undertaking specialized financial functions. At the base of this complex are the 4.7 million individual members (out of a total population in Quebec province of 7.5 million) who have day to day interface with a local credit union called as the "Caisse Populaire". Desjardins represents 80% of the population in Quebec province – including children who are members of the co-operative network. The movement is almost a hundred years old – the first Caisse being set up as far back as in 1900, by its founder Alphonse Desjardins. Ever since, the movement has grown stronger, while remaining true to co-operative values and democratic spirit.

Brief History

The movement of Desjardins started in the year 1900. The first Caisse Populaire was set up in response to the usurious interest rates being charged by moneylenders. Alphonse Desjardins was greatly influenced by the experiments that were carried out in the European Nations – including Germany, France and Britain. In particular, he was greatly influenced by the Raiffeissen model of Germany and by a book by Henry Wolf titled *Peoples Banks*. Based on the experiences of European nations and the peculiar needs of the province of Quebec, he formed the first Caisse Populaire in the city of Levis. At that time, there was no law governing the formation of Caisses in the province of Quebec. It was only in the year 1906, that the Quebec Legislature adopted a bill on co-operative unions giving the Caisses a legal status. In 1907, Alphonse Desjardins started promoting Caisses across Quebec. The Quebec clergy provided much help by providing a legitimacy, recognition and moral support to Alphonse Desjardins in his endeavor. However, it is to be stated that Desjardins never received any outside money. The growth of Caisses increased rapidly after there was a legal approval and more than 200 Caisses were formed before 1920, the year in which Alphonse Desjardins died at the age of sixty-five.

From 1920 onwards, while the work of forming more Caisses continued, a successful attempt was made to group the Caisses under a federal body. The objective of the federal body was to promote, regroup and strengthen the activities of the Caisses.

By the year 1932, apart from many more Caisses, several regional federations had been established. All these regional federations confederated under a single provincial confederation. The role of inspection was then shifted to the confederation. The growth of the movement also accelerated during the decade of 1930s. By 1944, the number of Caisses had reached a number of nearly 900 with over 300,000 members, and an asset base of \$92 million. During those years, the rest of the regional federations were also established.

The confederation expanded its role to add other services to support the development of Caisses apart from inspection. While the basic activity still remained loan and savings, the confederation diversified into insurance. This was done in the year 1944 by establishing the Assurance fund for the Caisses Populaires and in 1948, by setting up Desjardins Life.

In the 1960, there was a major diversification of the movement. The movement purchased some insurance and trust companies. In 1963 a new law was passed reconfirming the role of the confederation as a supportive and quasi-regulatory body.

By 1979, the movement had taken to computerization and passed on the benefits automation to the members. Desjardins was one of the few institutions in Quebec to adopt technology at such a fast pace. Also set up in 1979 was the Caisse Centrale Desjardins which operated as the movement's financial agent in the international markets. In 1981, the movement acquired the franchise of the VISA network and also set up its own network of automated teller machines (ATMs).

What we see today is what started in 1900 as a simple group savings activity which has, turned out to be the a complex structure that has brought to the doorstep of the members of the Caisse Populaire - a whole range of financial services. The current menu of financial services include loan products for varying needs, banking services including checking accounts, term deposits, credit and charge cards, automatic teller machine counters and internet banking. Apart from banking, Desjardins Movement is involved in insurance, marketing of mutual funds, investment services for individuals and corporates, brokerage services and international services including export and import financing, currency accounts, travellers cheques and so on.

The Structure

Desjardins Movement is a complex structure. The structure is basically divided into two parts – the cooperatives and the corporations.

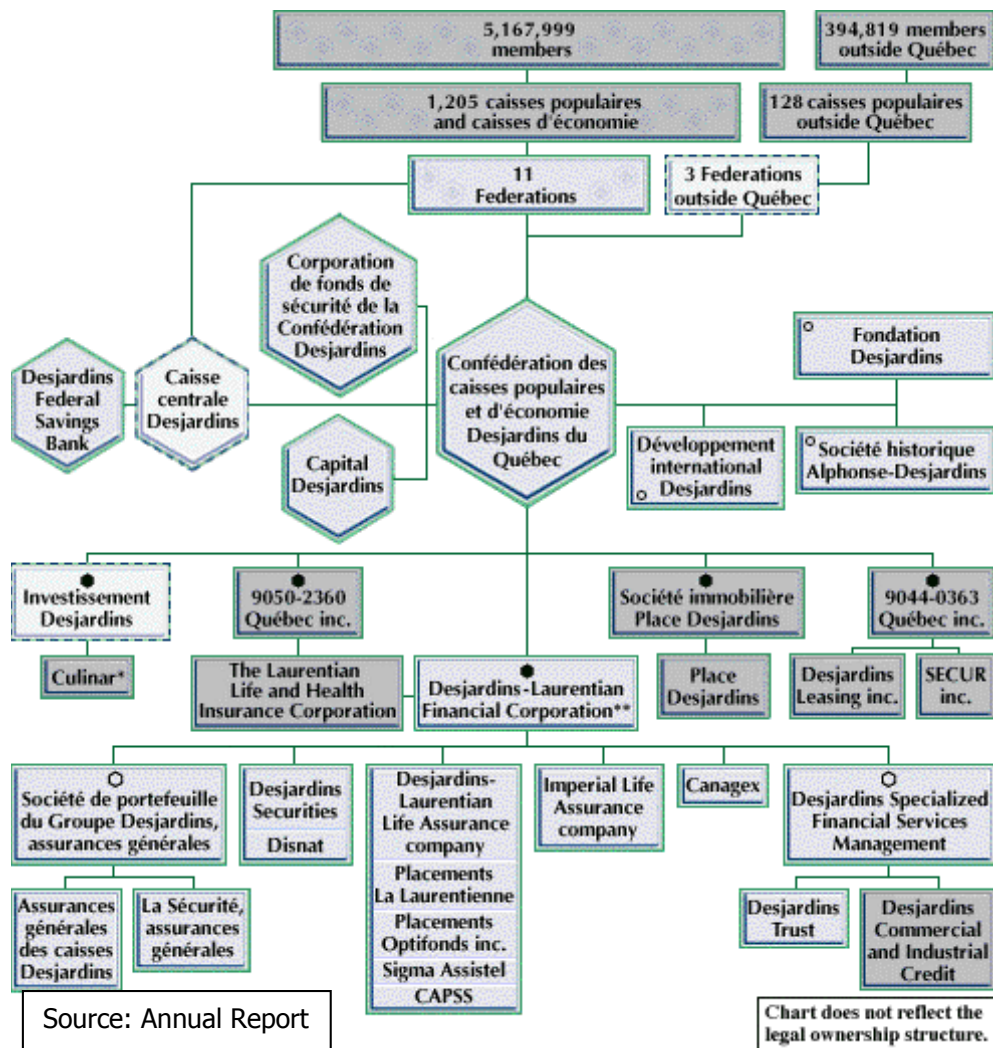
Currently Desjardins Movement has over 5 million members joining together in over 1200 Caisse Populaires. These Caisses have federated into 11 federations and the federations in turn are members of the confederation. (See picture above.) There is some activity being carried outside of Quebec Province also.

The corporations are all subsidiaries of the confederation. In addition to the corporations, there is a lateral co-operative structure that includes the security fund, Capital Desjardins and Caisse Centrale Desjardins. All these entities are interwoven. At the member interface level – there is only one entity with which the members deal on a day to day basis – the Caisse Populaire.

Caisse Populaire: The Foundation of the structure

At the very base of the movement is the Caisse Populaire. The Caisse is where most of the member interface takes place. We should highlight the fact, that the movement itself is a complex linkage of independent entities. Therefore, the Caisse is a distinct and independent entity only linked to the rest of the institutions in the movement. It has its own income statement and balance sheet and therefore has to constantly worry about its own bottom line, while working in congruence with the structure.

There are 1275 local Caisses with 4.7 million individual members in the Desjardins movement. The asset base of all the Caisses put together are a significant \$54 Billion out of a total asset base of the movement of \$72 Billion which is 75% of the total assets (all figures as on 31 December 1997). This indicates the member centrality in the business of Desjardins. While the other 25% are also purely add-on services to the members, 75% of the assets of the movement come from the co-operative network involving small individual transactions. This only shows how member driven the movement is.



Anybody could become a member of the Caisse, by paying in a membership of \$5. In 1997, the Caisses have an average membership of 3686 – while this might be higher in larger places like Quebec City, Levis and Montreal, it could be small in smaller villages. For instance, in Caisse Populaire de Frampton, where we spent a day, the membership was around 2800. The membership amount of \$5 has been constant ever since the first Caisse was set up and continues even now. In return for the membership, the Caisse opens its doors for a host of financial services to the members. The average memberships of the Caisses have been significantly increasing over the years. For instance, in 1987, there were 4.2 million members associated with 1345 Caisses, which meant that the average membership was 3122 per Caisse. This increase in average membership is not only because the absolute membership in each Caisse is increasing, but also because several Caisses are amalgamating. Under the re-engineering process the movement plans to bring down the total number of Caisses to around 800 in a time span of around five years.

The Caisse is an outlet for all the services of the movement. It has all the facilities that would be offered to the customer-members of the movement. The major activities of the Caisse would of course be the basic banking services – checking accounts, savings products, and loans both for production and consumption purposes and payment systems. All the Caisses have ATM facilities, and the members are encouraged to use the teller-machines for their day to day activities. Typically a Caisse would also have financial counselors, who spend time with the members on

understanding their financial services needs. These counselors were initially loan officers but with increased automation, the roles of several employees is now being redefined.

In addition to the financial services offered by the Caisse directly – for instance all the basic banking services are offered by the Caisse and these affect the Caisse’s bottom line directly – the Caisse also acts as a routing channel for the other services of the movement.

The financial counselors, for instance, apart from loan and savings products of the Caisse, also sell pension fund plans and mutual funds to the members. In due course, the Caisse would also be selling insurance products to the members, where the income does not accrue to the Caisse directly, but accrues to that particular entity within the movement. So technically a Caisse is not only competing with other Caisses within the region but also with some associated organizations. For instance when a Caisse sells a pension fund to a member, it basically loses its own deposit base – because the member is replacing the deposits with a pension fund. This is a contradiction that the whole movement, particularly the Caisse will have to live with if it has to have the access and benefit of the technology, which could be feasible only at scale.

It is possible for the same person to be a member of more than one Caisse. For instance in Frampton, while there were only 1300 residents in the “parish”, the Caisse had 2800 members on its rolls. Typically this would happen if his workplace were different from his place of residence. Part of the reason why Frampton had a larger membership is explained by the autonomy enjoyed by the Caisse – Frampton Caisse did not charge service charges to its members and therefore was attracting members from other areas also to join Frampton. In essence, this means that there is also no demarcation of the area to which a Caisse could cater. Normally, a significant part of the membership for a Caisse would be from the village/town (parish) where the Caisse is located and it's surrounding areas. However, this is only some sort of an imaginary demarcation. In theory there is nothing that prevents Caisses from operating beyond the “parish”. So, while all the Caisses belong to the movement, they sometimes compete amongst themselves.

The Governance structure of the Caisse Populaire

Till recently, the Caisse Populaire has been governed by three representative bodies - the committee of administration, the committee of audit and ethics and the credit committee. However given the changed circumstances, most of the Caisses have done away with the credit committee.

This stems from the fact that in the past, when information technology was not as advanced – the credit committee would act as a body which knew the applicants and therefore would be in a position to take decisions on loans. Now that sophisticated information technology tools are available three changes have occurred.

1. At the Caisse level, there is access to the credit history of the borrower through the computer. Not only could one access the credit history, but one could also look at the other transactions of the borrower and get an assessment of his/her financial behavior in terms of savings and other activities.
2. Because of increased competition and the presence of other financial institutions, the personal knowledge of the member’s creditworthiness is not as evident as it used to be in the past. The member can access other sources of finance and could easily deal with some other bank without his neighbors knowing the details of the transactions.
3. Because of increased competition more and more sophisticated loan products are being offered and it is often felt that the credit committee might not have the capability of assessing the loan. After all, the credit committee consists of local members and not experienced bankers; it is therefore become more and more important to leave these decisions to capable professionals, who have special training in the matter.

The committee of surveillance carries out internal audit of the Caisse. With the sophistication and the maturity available in the inspection department (a description will follow later) the role of the audit committee is also somewhat ceremonial. However, where there is an issue of conflict of interest amongst members, it is the Ethics Committee, which takes a stand. The inspection department of the confederation has a very detailed audit and surveillance system that works out to be very effective.

The committee of administration carries out its activities like a board of any institution. It is not necessarily the case that all policy decisions are taken by this body. Several policy directives do come down from the federation or the confederation. It is for the committee of administration to accept and adopt these directives. For instance, the Caisse regularly gets the interest rates from the federation. While in theory each Caisse could adopt its own interest rate structure to suit its local competition, normally the federation would intervene if such a stand by a Caisse were to result in an inter-Caisse competition. For instance in Frampton, we saw that they were not charging service charges, which resulted in the Caisse getting 2800 members against a resident population of 1300 (though this was not the only reason for increased membership, we were told that it was a significant reason). There was immediately pressure from the movement to align the services charges with those generally followed by the other Caisses and suggested by the federation.

The committee is also authorized to approve the accounts of the Caisse and recommend patronage payments. But most of these are governed by the broad guidelines pertaining to the capitalization requirements of the Caisse. The General Manager of the Caisse reports to the committee of administration and is a full-fledged employee of the Caisse. However, given the current conventions, it is not possible to hire or fire the general manager unless approved by the federation. Over a period of time, as technology develops and most Caisses are getting to be interconnected, it is seen that the trend is moving towards standardization across Caisses. The roles of the various committees are getting to be limited to ceremonial roles. They however, still provide a strong tie with the community; moreover, the aspirations of the members still get articulated through the committees - including broad approval or disapproval of larger issues.

Desjardins: Response to Competition

As the competition from the chartered banks is increasing, there has been a move to re-engineer several of the activities of the movement and the Caisses are also equally a part of the process. At the level of the Caisse, the major issues that are affecting them are:

1. There has been an increasing pressure to reorient the staff of the Caisse – firstly the staff is being requested to move away from routine activities to more creative activities. The routine activities such as counter transactions are being moved towards teller machines, telephone banking and Internet. It was found that there was some amount of resistance (in smaller places) from the members to use the teller machines. But the cost advantage of using a machine far outweighs any resistance shown by the members. In the new set up, the employees of the Caisse would perform the role of financial advisors to the members, thereby selling the other services of the movement which might have been taken away by the competitors.
2. There has also been an increasing pressure for Caisses to merge and cover a larger area with lesser overheads. This is also a measure directly oriented towards addressing competition. The average branch of a chartered bank handles many more clients than an average Caisse. In case of Frampton there were two branches of other chartered banks, which have closed down. They now cover the clients of Frampton from a town 15 kilometers away. A different

Caisse covers that town. The movement is concerned about the overheads involved in maintaining offices with double overheads.

3. The third issue that the Caisses have been grappling with is that of having to serve a wide range of clients including the smaller clients. This is done by a self-imposed mandate of "open membership" wherein any person could avail of the membership of a Caisse with a share contribution of \$5. The competition is cherry-picking the top members of the Caisse and offering them better deals while leaving the smaller clients to the Caisse. This hampers the viability of the Caisse, essentially because there traditionally has been an internal cross-subsidy between the larger and the smaller clients. The dilemma is between flexibility and standardization. While standardization has been imposed to ensure that Caisses do not compete amongst themselves, it has crippled the Caisses' ability to compete with the other institutions in trying to retain the large clients. To give an idea of the magnitude of the issue, we were told in Frampton that 6% of the members represent 80% of the deposits in the Caisse. The ratio was somewhat better across all Caisses where 5% of the membership represented around 30% of the deposit base. But could Frampton offer higher rates to retain the customers going away to other banks? Is this going to be at the cost of attracting members of the other Caisses to Frampton? This in particular is the dilemma, which currently haunts the movement.

There is a very widespread knowledge of the competition and its impact on the functioning of the movement as a whole across all layers of the movement. We found that everybody in the movement is concerned about the changed economic situation and the issues at hand. This in itself is an important feature of any member-driven organization - that all layers of the organization are fully aware of the issues at hand and the implication of not yielding to change. However since the movement is people driven, there is also a lot of concern about personal interface with members, job cuts and other related issues.

The Middle-Tier: The Federation of Desjardins Caisses

After 1920, there was a felt need to get the Caisses together. Though Alphonse Desjardins had worked on the design of the regional federations, he did not live to see the federations being set up. The main reason that the Caisses came together to form federations was the necessity for installing an inspection system and creating new services. We can see the first attempts to have self-regulation as early as 1920, which has grown to be one of the strongest points of the movement to this day (we would be describing the aspects of self-regulation later).

Currently, all the Caisses are federated into 11 regional federations. Now, *each Desjardins Caisse is affiliated with a federation that helps to promote its efficiency and growth* (Annual Report, 1997). The role of the federation is to provide the Caisses with common services in areas such as *training, communications, technical support, selection, hiring and management of human resources, management of the Caisse-federation network, credit and finance. The federation is also responsible for deploying various business process reengineering projects in the Caisses, helping them set up and follow their business plan, and assisting them with their sales efforts.* (Annual Report, 1997).

The elected representatives of the Caisses govern the federation. Normally, there is a regional representation on the board. The board has both volunteer governors as well as managers who are elected to the board.

While the functions initially performed by the Federation - of audit and inspection has been long transferred to the confederation the other activities are also now being increasingly taken up by the specialized subsidiaries of the confederation. In the analysis of competition from the other players in the market, there has been a lot of introspection on the role of the federation in the

changed scenario. It now appears that with information technology changes and sophistication of the operations of the other specialized services, the relevance of the federation could be questioned. In the last general meeting this aspect was thoroughly discussed and decided to cut the costs of running the movement by removing the middle tier. This however has to be done carefully taking into consideration the cultural and governance aspects of the change - both of which have been so dear to Desjardins. The strategy here is to move gradually in the process of re-engineering. In addition, there will be consolidation at the primary level wherein the number of Caisses will also be gradually reduced.

While the reason for consolidation is very clear and is driven by survival of the co-operative movement in the face of competition, Desjardins movement will have to guard themselves against losing the member interface, and will have to find innovative ways of continuing to have member contact. The issue that haunted the Scandinavian consumer co-operative movement of scaling up in the face of competition will have to be examined in detail to ensure that the basic spirit of co-operation is not lost. Each of the steps being taken by the movement is perfectly justified in the light of competition - like trying to move members away from the counter to the ATMs, and towards internet banking. The change of roles of the loan officers to financial counselors, disbanding the federation and consolidating the Caisses. The challenge here is that this results in the process of standardization; it will become a challenge to ensure that the locally elected leaders of the Caisses continue to play a distinctive role. This undoubtedly will restrict the local autonomy. The movement will have to introspect and decide how to prevent the Caisses from becoming branches of the confederation rather than continue as autonomous units of a movement with a shared vision. This is a tough task indeed.

The Confederation of Desjardins Caisses

The confederation performs a very pivotal function in the whole Desjardins movement structure. It is the confederation that provides the interface between the basic co-operative structure and the other corporate entities. *The primary mission of the confederation is to support and coordinate the activities of the Caisses and federations, to back them up and assist them in their ongoing efforts to improve their services.* (Annual Report, 1998).

With the given complexity of operations and the federations performing a limited role, the importance of the confederation is going to be more and more crucial and critical. The confederation has some lateral organizations like the Security Fund and Capital Desjardins. Apart from this, it works closely with the Caisses through the Caisse centrale Desjardins that is responsible for the treasury and fund management of the movement. In addition, the confederation has promoted a host of corporate subsidiaries including in areas of insurance, international banking, specialized financial service management including leasing, commercial credit and industrial credit apart from Desjardins securities.

While during the trip we did not have the time to get an exposure to all the divisions of the confederation, we were exposed to certain critical divisions of the confederation which we thought was of crucial importance. We spent considerable time understanding the systems division, the security fund and the inspection and audit division of the confederation. These in any case were the most crucial functions undertaken by the confederation vis-à-vis the Caisses.

The nature of financial transactions between the Caisses and the confederation was something which we could not examine, in great detail during the trip. However, basically the Caisses paid the federation a fee for administration, the confederation for and systems development and a fee for administration and some amount to the security fund, all on the basis of total assets.

This part of the report will deal extensively with the three important functions undertaken by the confederation.

Business and Product Development

One of the roles of the confederation is also in designing and delivering new products that could be used by the members of the Caisses. We were exposed to a new product that was developed by the confederation during our visit. The role of the confederation is essentially in assessing the need for such products, and then working out the detail as to how the product should be designed and delivered.

The confederation recently designed a product for the small entrepreneurs. The basic design feature was in offering loans for differing needs as a package and on a modular basis to suit the increasing needs of the member. It would be worked out that the member might need financial services of the movement at different points of his business cycle and that need had to be addressed. The relationship could start with a small loan for business, insurance associated with it and later go on to add other necessities of the member - transportation vehicle, a credit card, a life insurance product and so on. Essentially, the package targeted giving the member everything on one stop. This would avoid making the member run around for each of the services.

In the above package, technical assistance was easily available as long as one was in the business of agriculture. For other trades, it was difficult to organize specific technical assistance programs. Business and financial counseling was available on an ongoing basis.

There were three questions that were raised vis-à-vis the role of the confederation in undertaking such activities for the Caisses:

1. *Where does the product idea come from?*

It appeared from the discussions that it was often the confederation that was looking for new ideas, though it was quite possible that the idea came from the explicit desire of some Caisses to try out something new.

2. *Was it always necessary for all the Caisses to adopt the new products developed by the confederation?*

It was not absolutely necessary for a Caisse to really adopt the product developed by the confederation. But invariably there would be a demand from the members who possibly saw the product elsewhere in other Caisses. Therefore, if it was a successful idea, it was just a matter of time before others adopted it. Of the several attributes of the product was also the pricing of the product. While the Caisses were free to charge differently from what was suggested by the confederation, their autonomy was really in a narrow band, as discussed earlier.

3. *Who pays for the research and development costs incurred by the confederation?*

Currently the payment to the confederation was on the basis of a fixed fee of 19 cents for every \$100 of loan assets. This amount is for meeting the administrative expenses of the confederation. This fee was irrespective of whether the Caisse used the product or not. Under the overall re-engineering program, the basis of charging a Caisse for the services of the confederation was under review and it is likely that the basis would change to actual services used in the near future.

Systems Support to the Movement

Desjardins movement has shown remarkable agility in adapting to information technology systems - right from the beginning. This constant innovation and the look out for more and more cutting edge technology are what put the movement apart from other institutions of similar kind.

The information technology division is now indicating that the movement is moving from physical branches (Caisses) to physical cum virtual branches.

From the paper-pencil era, the movement has moved much ahead along with the technology. It started its automation with an IBM machine in 1979 about 20 years ago and set up its first teller machine around the street-corner about 15 years ago. It is also connected to the International Cirrus Network, connecting banks and other credit card companies. Around 10 years ago, the real online processing facilities were established. From then on, the movement has moved much further by launching the web banking service in December 1996. It currently has 1800 servers and 30,000 terminals & 2,100 ATMs.

There is a phenomenal saving in operating expenses if most of the transactions are shifted to the machine. An estimate by Booz, Allen and Hamilton Inc., indicates that the cost of counter banking is around Canadian \$1.07 per transaction whereas web banking costs only 1 cent per transaction. Initially, when the first technology of shifting from the counter to the teller machine was introduced, the transaction cost saving was only for the movement - because the member in any case had to come to the Caisse or to the nearest teller point to undertake his transaction. But the later shifts - tele banking and Internet banking have not only reduced the transaction costs for the movement, but also for the members. This of course assumes that the members have a telephone, computer and Internet connection at their residences anyway.

While one of the concerns expressed are that the personal touch which members used to get is somewhat lost in the process of automation, it is imperative that a shift is made towards such a technology for sheer cost and competition reasons. The movement is trying to find ways and means of increasing member interaction by redefining the role of several of its employees and sending the routine transactions to the machine.

The architectural group in the movement looks up all the new trends in technology and how it could be adapted to the movement. One of the major challenges to the systems department is to keep up with the technology and adapting to new technologies while maintaining the old systems in place. Since Desjardins was one of the first institutions to adapt to information technology pretty early, it has to cope up with what is called the "legacy software". Even now the movement follows the system of sending printed reports to the Caisses rather than electronically transmitting the information or giving more access to the database. This appears to be a hangover of the "batch processing" culture of the legacy software. Most of the software is peculiar to the needs of the movement. All software development is done in-house and very little is out-sourced. This is partly true because the front-end software has to be in French rather than in English.

Apart from the transaction interface software, the systems group also helps in maintenance of the database on various aspects. As we will see later, the inspection and audit department has written its own package Indis that extracts the data from the database, which is useful for inspection. This is done in collaboration with the systems group.

The systems group is constantly working towards data security and multiple security features have been built in not only in the software, but also in the physical location where the servers and data files are maintained. There are also facilities for sufficient back up and in case of any emergency, the entire database could be restored in minutes. In fact, Desjardins does regular maintenance of machines without any downtime at the customer interface level. Depending on the bottlenecks at each stage, memory, storage space and processing capacity are added when the first signs of slowing down are seen.

All systems development is done at a centralized level at the confederation. All costs of systems development are allocated to the Caisses on the basis of their asset size. The movement has not

evolved a system wherein the Caisses could be charged on the actual usage of the services rather than on a fixed percentage based on their size. With so much of information available on the transactions and processing loads, it should be possible to do a realistic costing and charge on the basis of usage in the near future. In fact, systems group truly represents the basic benefits of the Caisses getting together as a confederation. This level of systems development and access to international markets could have happened only when the structure evolved by Desjardins was evolved. The structure is a good mix of autonomous Caisses that have the benefits of a large corporation because of inter-co-operation.

However Desjardins will have to address two major issues:

1. With a large aging population as its members, how does the movement address the issue of resistance to using machines and still wanting to do counter transactions?

This issue was brought to sharp focus in our visit to Frampton, where some of the members are quite old and are unwilling to learn how to operate an ATM. Not only are they unwilling, but they also insist on going to the counter just because they feel like having a chat with the counter clerk as the transaction is underway. The strategies that the movement is looking at are to reduce the number of tellers and therefore force the members towards the ATM because there is bound to be a delay at the counter. But it appears that a significant portion of the members is willing to wait! The other strategy is to charge heavily for counter transactions, so that the costs of wanting to talk to the teller are recovered!

2. How does the movement plan to cope with the resultant job cuts, particularly being the largest employer in the Province after the Government?

Because of increased competition and resultant automation, there has been an inherent fear amongst all the employees about possible job cuts. This feeling is widespread not only amongst employees, but had also spread to members. It was telling in Frampton when the manager indicated that some of the members insisted on going to the counter on the ground that the teller might lose his/her job if they do not use the counter service. This is bound to be a very significant issue for the movement in the days to come.

However the positive side of technology apart from reduced costs were that there was a scope to do so many more things. For instance, the Desjardins web site indicates that only 2.4 % of the members participated in their Caisse AGM in 1997. It may be possible to increase this figure significantly by having interaction on the Internet on the issues that are haunting the movement and possibly have internet based voting on certain issues. But the issue still remains that given the demographics of Quebec, how does one encourage the members to use the technology. Perhaps this may have to be addressed by the group that addresses the issues co-operative member education. After all, as a member driven organization, it would be imperative that Desjardins keeps its members at the same level of technology as the movement itself is adopting. This is a big challenge indeed.

Self Regulation: Audit and Inspection

The audit and inspection services of the Desjardins movement are the most fascinating examples of self-regulation. This only shows the foresight of the founders as to the importance of being a good corporate citizen ab-initio. Though the inspection department is a part of the confederation, it has been given as much autonomy as an external auditor or inspector would have. The office is physically located away from the confederation and has its own autonomous functionaries.

The audit and inspection wing is called the "Bureau of Financial Monitoring and Enforcement". The Inspector and Auditor General who is the chief of this wing is appointed by the board of the

Confederation. The bureau monitors if all the organizations within the movement are administering their business accounting to recognized sound and prudent business practices and accounting norms.

The independence of the Bureau has been given official recognition by the IGIF. The statutory body of the government has delegated the functions of monitoring and inspection to the Bureau. The bureau therefore actually performs the role of the Provincial Government. All the Caisses of the movement are fully audited by the Bureau and they issue audit certificates. The IGIF only does random inspection on certain selected Caisses, and that too on the database maintained by the bureau. Only when that the IGIF is not satisfied by the answers and reports of the bureau that they actually decide to go to the Caisse for inspection. So good has been the track record of the bureau that the IGIF has never felt the need to visit and inspect a Caisse.

The bureau not only does the audit and inspection of the Caisses, but also had devised a system of surveillance and monitoring through a computerized program. In fact, before embarking on the audit of a particular Caisse, the data of the Caisse is fully analyzed at bureau and the database is loaded on to the laptop computer of the inspector. This helps the inspector to focus on areas where s/he thinks that the audit should examine in detail. During our visit, we were able to call up the data of Frampton, where we had visited the previous day and connect the data to what we had seen on the ground. In fact, this gave us a better picture of the system because we were able to relate it to what we had seen on the ground.

The bureau not only does the audit of the Caisse, but also advises them on prudential norms of accounting and income recognition. For instance, the income recognition norms provide that any depreciation in the underlying value of the collateral has to be fully provided for, even if the installments of the loan are all coming in on time. We saw a specific instance wherein Frampton was asked to make a higher provisioning because the real estate prices had crashed and the underlying value of the apartments that were financed by Frampton had gone down.

The independence of the audit and inspection process was confirmed, not only by the Caisse, but also by the bureau itself. We were told that the bureau exclusively uses the package developed for monitoring of Caisses and the Caisses do not have access to it, though it might have very useful information that could be effectively used by the management of the Caisse. The specifics that are covered in the audit and inspection of local Caisses include - compliance with laws and by-laws, internal control systems, business ethics as elucidated by the movement, and sound financial practices.

Apart from the audit and inspection of the Caisses, the bureau also carries out the internal audit of the confederation. However, the inspection and of the confederation itself is done by the IGIF. The confederation and the bureau have an arms length relationship and therefore an objective internal audit is possible.

As regards the federations, the bureau carries out regular inspections and does co-audit along with the statutory auditors. It also supports the federations in regulatory disclosures and reporting. The corporations under the movement have their own respective auditors set up in the AGM. The bureau has a very limited role to play as far as the corporate wing of the movement is concerned.

Self-Regulation: The security fund

Apart from audit and inspection, the Desjardins movement really believes in other forms of self-regulation. One of the unique features of the movement is the amount of internal systems that they have built in. The security fund is one such step taken by the movement to ensure that each member Caisse is protected against adversity. The fund was initiated in 1980 and currently

stands at \$351 million (31 Dec 1997). Every year the Caisses contribute a part of their total asset size to the security fund. This is actually expensed off from the income statement and acts as a reserve fund of the movement. In years where the Caisse has difficulty, the security fund contributes to the Caisse to ensure that they do not report losses. But the moment the Caisse receives money from the security fund, there is immediately attention both from the bureau and the confederation. Firstly they require the management of the Caisse to get back to shape. It might also involve a change in management, a temporary takeover of management from the confederation and increased surveillance and control.

In case a Caisse receives contributions from the security fund, the amount received from the fund is made good in the future years through higher contribution. This ensures that no Caisse is flippant in its own management. Moreover, the cost to be paid for receiving contribution from the security fund is the autonomy of the Caisse itself, which is a significant matter.

By creating the security fund, the movement has provided a double safety for the members. Firstly, if there is a particular Caisse, which is in trouble, it is bailed out through the contributions of the fraternity - the Caisse's own contribution and that of the other Caisses. The deposit guarantee funds of the Provincial government are tapped - if necessary - only after the all the funds available within the movement are exhausted. Given the quantum of fund creation at the security fund level, such a contingency is very unlikely. In fact, the Desjardins Caisses have never called on the deposit guarantee funds of the Provincial government.

One of the most notable features of both the higher provisioning norms and of providing for the security fund are that both these provisions are tax deductible and could be expensed off. It was found that the Provincial government was responding positively to the needs of the movement by creating an enabling legislative environment where self-regulation could flourish.

The Corporations

Apart from the activities described above, the movement has many corporations, which undertake specialized functions that service the membership of Desjardins. In fact, the movement has in the past acquired business to suit its strategic needs. A few years ago, the movement acquired the Laurentian Group, which had interests in banking, insurance and other financial services. Part of the reason for acquiring the group was that, Desjardins wanted a Bank under its group. Though Desjardins was carrying out banking activities, it was not a "bank" under the Royal Charter. In Canada, the law does not permit co-operatives to register under the Banking Act. While, the movement has been advocating that there should be scope to register co-operatives as co-operative banks, the legislation has not yet been passed. However in the past two to three years, the movement has reviewed its acquisition and has sold off the bank while retaining the insurance business.

The **Desjardins-Laurentian Financial Corporation**, which owns the insurance business, carries out the activities undertaking both life insurance and other products of insurance. The insurance companies offer a wide-ranging menu of insurance products for the members. Till now, the provincial law had not permitted employees of the Caisses to get licenses to sell insurance products. Therefore, the Caisses could only refer their members to an authorized agent of the insurance company. However, now the provincial law permits the issue of licenses to the employees of Caisses and therefore, in years to come we would be witnessing the employees of Caisses performing the true function of financial counselors.

Apart from the insurance business, the movement is active in the investment market. It has its own full-fledged investment company that manages the investments of the surplus funds of the Caisses. The company "**Investissement Desjardins**" plows back investments into strategic businesses mostly within the Province. By being a separate for-profit entity the corporation can

take independent decisions on taking equity positions in businesses within the region. While it is possible to imagine that the Caisse could be doing such investments in its own local areas - this is a cleaner way of carrying out the business because the returns from such investments could be closely monitored.

Desjardins Securities offers the members a menu of financial instruments in which they can invest - like pension funds, mutual funds and stocks. While this means that the members are moving their savings away from in the movement because of low interest rates offered by the Caisses, it ensures that the income stream from offering such services is not totally lost. This also represents the responsiveness to the specific needs of the members. This corporation has a significant amount of non-member business, but is moving towards increasing the member business. As of the end of 1997, the members represented 54% of the clients. Currently this could be seen as an auxiliary business because the total assets under administration are around \$3.44 billion as against the combined member savings of \$37.67 billion. However if the members prefer to invest more and more in mutual funds and stocks, then the Caisses would be under pressure. While the corporation would earn good profits - the movement as a whole, would be losing member deposits and they in turn will have to borrow from the international markets at a higher rate. One way of rewarding the members, is by giving higher patronage payments at the end of the year - but that in turn raises the question of capitalization for the long run. An added question is whether the members see the patronage payments as a significant enough amount to temporarily ignore the nominal coupon rate on their deposits. This again represents a dilemma for the movement - how to be responsive to the needs of the members which might be getting more and more sophisticated, the preference for savings instruments is moving away from the core products that the movement is offering.

In addition to the above corporations, there are a few other corporations that perform very useful functions in the movement. The Desjardins International Development with whom BASIX is working has had an impeccable track record of forging alliances and carrying out development activities in several countries. *DID offers technological transfer and expertise services to financial co-operative institutions or to Government agencies that support or regulate these institutions in 25 countries throughout Asia, Central and Eastern Europe, Africa and the America (Annual Report, 1997).* BASIX and Sanghamitra in India are the partners that DID is working with and DID surely would be looking for more partners to carry on its developmental agenda. There are other smaller corporations with fit in very well into the jigsaw of the movement.

Learnings

The study of Desjardins did provide a whole new insight into the strengths and weaknesses of the co-operative structure. Firstly, the very fact that the ownership of the movement is so dispersed that it is virtually impossible to take over the co-operative speaks volumes of the strength of the co-operative structure. However, Desjardins still struggles with all the internal contradictions of any co-operative. Desjardins has now grown large enough to have a significant international presence. But the international markets are ruthless and do not care about the ownership pattern and the associated peculiarities of the structures of institutions such as co-operatives. For instance, when Desjardins approaches the bond rating agencies for a rating - the organization that is assessed is the Caisse Centrale. The rating agencies would not put a heavy weightage on the consolidated balance sheet of the movement - essentially because the Caisse Centrale's balance sheet would not include the underlying assets of the movement. Technically each of the Caisses is autonomous and is just having a membership of Caisse Centrale. So, naturally, when the movement has to borrow in the international markets, it will have to rely on the strength of the balance sheet of one of its entities! Even when the movement is being evaluated, it goes through the same parameters as the private banking corporation. There are no good marks for dealing with small clients and therefore having a thinner spread. There is a need to learn how to cross subsidize between large and small borrowers. We need to learn how

to keep the small customers very much within the focus as we continue going through the rigor of being assessed along with other mainstream organizations.

The second problem that is associated with the co-operative form of organization is that of internal capital formation. For instance, the total asset size of the movement of \$ 54 Billion (as on 31 December 1997) was financed through a total equity of 4 billion (7.4%) of which the paid in capital was only 730 million which was only 1.35% of the entire sources of funds. The rest of the liabilities side was made up of deposits and borrowings. This essentially means that the stakes identifiable with the members was only 1.35% of the asset size, while there were heavy internal accruals over a period of the growth of the movement, which was transferred as reserves. This also was only 7.4% of the entire asset size. Notwithstanding the above, there is a significant amount of member-stake in the form of deposits in the movement. The individual deposits in the movement was around \$37.6 Billion (69.63%). However the most important aspect to be noted is that these member deposits could be volatile and may not be permanent in nature. Thus, the whole movement is quite vulnerable to a takeover not in the terms of ownership but in terms of membership base - which for competitors would translate as customer base.

These two issues would be significant issues the movement has to grapple with in the future. The risk of becoming a breeding ground for early customers whose bankability is not established is always there. Once bankability is established, they might be cherry picked by the competition leaving us, eternally with an experimental customer base. Second, and more important issue is how to build customer stake in the organization. Our major learnings from Desjardins would actually come from how the movement copes up with these issues in the next four to five years. We are currently in a safe market with little non-price competition from formal sector institution - but this scenario might not last long.

The challenge for Desjardins itself would be on how to remain capital adequate and grow. Since their primary strategy of capital accumulation is through plow back of profits it becomes more and more difficult raise more capital in an acutely competitive situation. Possibly the answer lies in aligning the share-holding or deposit pattern to some of the services utilized. This type of solution however needs a deep study as to the situation in Quebec Province and an analysis of the competition before it can be effectively implemented.

Another significant learning has been the phenomenal amount of technology that the movement has used at all levels. Not only has the movement used the technology effectively - it has been pioneering in its efforts. Given the cost structure and the remote areas in our country, the only way of being effective is through the use of technology. How agile the Desjardins systems group is, considering that they are the largest employer apart from the government is an indication of what such institutions could do in India as well.

In addition to the above, the most significant learning has been on how important it is to be a self-regulated organization. We have learnt that the best way of achieving autonomy is by exhibiting excellent standards of behavior. Self-regulation not only involves high levels of compliance to internal systems through audit and inspection, but also in setting standards for the industry on business practices so that the law makers are inspired by the industry to frame enabling legislation. We have also learnt a great deal about systems, accounting, provisioning and income-recognition norms that are all so much a part of the best business practices.