

# Credit Unions: Social Enterprise at Work

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## Abstract

Although the notion of social enterprise first appeared in Italy in the late 1980s, it really began to be used at the European level in the mid-1990s, especially through the works of the European Research Network (EMES). EMES defined social enterprises as "organisations with an explicit aim to benefit the community, initiated by a group of citizens and in which the material interest of capital investors is subject to limits. They place a high value on their independence and on economic risk-taking related to ongoing socioeconomic activity." Although a social enterprise could have one leading person, often referred to as the social entrepreneur, to initiate and drive it requires the support and engagement of many other people. Therefore, the cooperative movement is another well-known manifestation of social enterprise.

**The main scope of research.** The development of social enterprises is rather challenging in Latvia. A significant restriction to the development of social enterprises in Latvia is the absence of legal recognition that social entrepreneurship is a form of doing business. The imbalance in the distribution of urban and rural credit unions is a prime reason to give more attention to the development of rural credit unions.

**Major findings and conclusion** is that the role of credit unions in the development of rural communities should be judged by the opportunity they provide for individuals to participate in the development of their communities by getting engaged in a social enterprise.

**Keywords:** social enterprise, credit unions, financial cooperatives, Latvia.

## Introduction

While there is no universally accepted definition of a social enterprise, their distinguishing characteristics are their social purpose combined with the entrepreneurial spirit of the private sector. J. Gregory Dees (2001) highlights two key characteristics that make social enterprises different from any other kind of business. The first is the social objective of a social enterprise: the primary objective of a social enterprise is to maintain and improve social conditions in a way that goes beyond financial benefits created for the organization's funders, managers, employees, or customers. The second is the blending of social and commercial methods: in addition to using the social enterprise's ability to tap into the goodwill of their stakeholders, they look for creative ways of generating revenue like purely profit-driven businesses. Where businesses are completely commercial, social enterprises are a hybrid of commercial and philanthropic methods.

Social enterprise - the use of market-based, civil society approaches to address social issues - has been a growing global phenomenon for over twenty years. They bring people and communities together for economic development and social gain. Social enterprises have emerged in different areas around the world in diverse ways. It is common for

social enterprise researchers and practitioners from various regions and countries to examine cases of social enterprises from a local perspective. Following that tradition, this paper describes credit unions as one of the models of social enterprise and analyzes the case of credit unions in Latvia. There is practically no research of the role of credit unions in Latvia as, while credit unions have successfully operated in Latvia since 1995, Latvia is not represented on the Social Economy Europe web page, or mentioned in the European Research Network 2008 publication 'Social Enterprise: A new model for poverty reduction and employment generation'.

Proposed approach is to consider credit unions as a form of social enterprise. Credit unions operating as financial cooperatives demonstrate high level engagement of society in financial activities with aim to serve the needs of their members, who contribute to their capital, owning and controlling them, rather than only provide them with an investment return. Method of research is content and comparative research based on publicly available resources.

## Results

The development of social enterprises is rather challenging in Latvia. One of the peculiarities of the development of entrepreneurship after regaining independence in 1991 was the dominant emphasis on profit-making at the expense of public purposes. A significant restriction to the development of social enterprises in Latvia is the absence of legal recognition that social entrepreneurship is a form of doing business. Public institutions and civil society have not yet succeeded in proving the need to include a social purpose within the concept of doing business. The situation in Latvia is not unique, as it is typical also for all of East-Central Europe as compared to Western Europe (tab. 1).

## The Cooperative - a Particular Kind of Social Enterprise

The stakeholders to whom social enterprises are accountable include a much wider range of people than just owners. Although a social enterprise could have one leading person, often referred to as the social entrepreneur, to initiate and drive it requires the support and engagement of many other people. Therefore, the cooperative movement is another well-known manifestation of social enterprise. Cooperatives are a particular kind of social enterprise, with clearly defined values and democratic principles (Price, M. 2008).

**Table 1.** Comparative Overview of Social Enterprise Models and Four Socioeconomic Factors for Europe.

	Western Europe	East-Central Europe
Social enterprise model	Civil Society/State	Civil Society/Int'l aid
Market performance	strong	weak
International aid	none	strong
State capability	strong	mostly weak
Civil society	strong	moderate

Source: Janelle A. Kerlin (2009)

All enterprises exist to serve the interests of their main stakeholder groups. For traditional companies that means serving needs of investors. However, in a cooperative, returns on capital are always be subordinated to other goals. Therefore a cooperative is an association of people - or a 'people-driven' business - and as such they promote a range of various participation. By fostering the participation of individuals, cooperatives work for the sustainable development of their communities through policies approved by their members. There are two kinds of comparative advantage to cooperatives: general ones derived from the nature of cooperatives as member-owned businesses, and particular ones derived from specific types of cooperative enterprise (Birchall and Ketilson, 2009). The defining characteristics for a cooperative are:

1. the possibility of free, open, and voluntary association and withdrawal from the entity;
2. a democratic structure, with each member having one vote, majority decision-making, and an elected leadership accountable to its members;
3. the equitable, fair, and just distribution of economic results; and
4. being autonomous and independent.

The importance of cooperatives has been highlighted by the European Commission, which has stated that cooperatives are an important part of European economic life and industry. There are 250,000 cooperative enterprises in the European Union, owned by 163 million citizens (1 in 3 citizens) and they employ 5.4 million people. It is stated that cooperatives are vital to building the sustainable Europe of tomorrow. The United Nations General Assembly has declared 2012 as the International Year of Cooperatives, highlighting the contribution of cooperatives to socioeconomic development. In adopting resolution 64/136 on 18 December 2009, the Assembly noted that cooperatives have an impact on poverty reduction, employment generation, and social integration. According to United Nations information, the cooperative sector worldwide has about 800 million members in over 100 countries and is estimated to account for more than 100 million jobs around the world (UN, 2009). As self-help organisations that meet the needs of their members, cooperatives assist in generating employment and incomes throughout local communities. Cooperatives provide

opportunities for social inclusion. In the informal economy, workers have formed shared-service cooperatives and associations to assist in their self-employment.

In rural areas, savings and credit cooperatives provide access to banking services that are lacking in many communities and finance the formation of small and micro-businesses, promoting inclusive finance. Promoting the cooperative model of enterprise has proved to be one of the ways to successfully mobilise people and their resources for local economic development. As businesses, financial cooperatives meet a significant gap in the market with a sustainable institutional and business model. This is based on being a member-owned service organisation reaching not yet served but bankable clientele with products determined by demand, and with prudent financial management based on members' resources and a 'savings first' approach to credit discipline. They promote participation because each member, regardless of their financial stake in the credit union, may run for office and cast a single vote in elections.

### Credit Union Operating Principles

Credit unions, as defined by the World Council of Credit Unions (WOCCU), are member-owned cooperative financial institutions and they have a long history of providing high-quality, affordable financial services to millions of people who have been traditionally excluded from the formal financial system. By serving individuals of all wealth-levels, credit unions are able to provide greater numbers of poor and low-income people with an array of savings, loan, and insurance products. Being a financial cooperative, credit unions follow very strict operating principles:

**Open and Voluntary Membership.** Membership in a credit union is voluntary and open to all within the defined common bond of association that can make use of its services and are willing to accept the corresponding responsibilities.

**Democratic Control.** Credit union members enjoy equal rights to vote (one member, one vote) and participate in decisions affecting their credit union, without regard to the amount of savings or deposits or their volume of business. The credit union is autonomous, within the framework of law and regulation, recognising the credit union as a cooperative enterprise serving and controlled by its members. Credit union elected offices are voluntary in nature and incumbents should not receive a salary.

**Service to Members.** Credit union services are directed to improve the economic and social well being of all members.

**Distribution to Members.** To encourage thrift through savings and thus to provide loans and other services, a fair rate of interest is paid on savings and deposits, within the capacity of the credit union.

**Building Financial Stability.** A prime concern of the credit union is to build its financial strength, including adequate capital reserves, and operating internal controls that will ensure continued service to members.

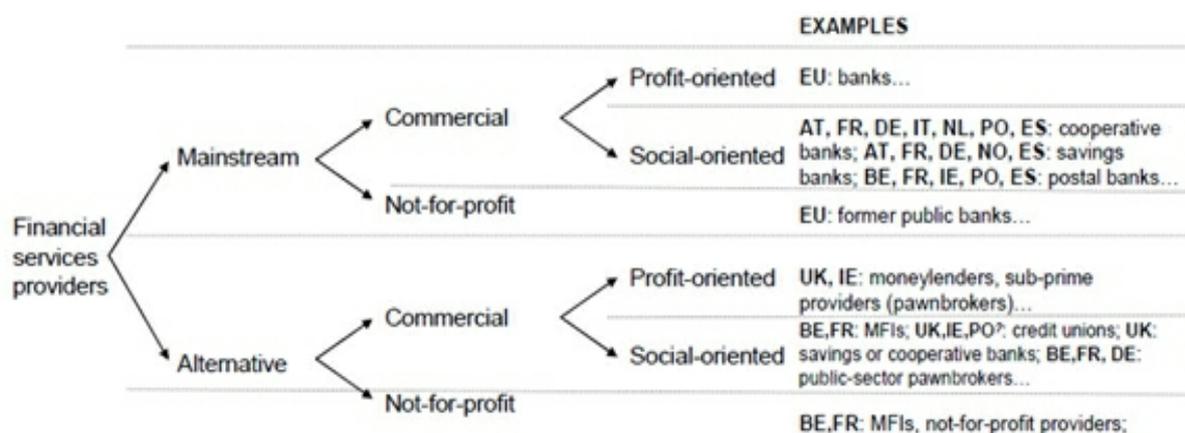
**On-going Education.** Credit unions actively promote the education of their members, officers, and employees, along with the public in general, in the economic, social, democratic, and mutual self-help principles of credit unions. The promotion of thrift and wise use of credit, as well as education on the rights and responsibilities of members, are essential to the dual social and economic character of credit unions in serving member needs.

**Cooperation Among Cooperatives.** In keeping with their philosophy and the pooling practices of cooperatives, credit unions within their capability actively cooperate with other credit unions, cooperatives, and their associations at local, national, and international levels in order to best serve the interests of their members and their communities.

**Social Responsibility.** Continuing the ideals and beliefs of cooperative 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. 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. Decisions should be taken with full regard for the

interest of the broader community within which the credit union and its members reside.

Under the umbrella of WOCCU, by the end of 2008 there were close to 200 million credit union members that were united in some 54,000 credit unions spread across 97 countries, including over 2,500 credit unions operating in 12 European countries, uniting nearly nine million members. As described by WOCCU, when compared to other financial institutions, a savings and credit union is unique because it follows a philosophy of self-help, member control, and economic democracy. Savings and credit unions generate local pools of capital that wouldn't otherwise exist. The source of development capital and its ownership and control are all at the local level. Credit unions are funded through member shares and deposits and therefore are not dependent upon the capital markets for funding. At the same time they also promote participation because each member, regardless of their financial stake in the credit union, may run for the board and cast a single vote in elections. The cooperative advantage of savings and credit unions was well demonstrated during the recent global financial crisis. The nature of credit union markets means that they were less exposed to the internationally traded financial instruments generally accepted as the root cause of the crisis. As credit unions are not driven by profits or shareholders interests, they were not compelled to force people into inappropriate loans. The type of ownership and methods of capitalisation are two of the key factors that have created the disparity in the financial position of credit unions and banks to the advantage of savings and credit cooperatives or credit unions (Coombes, A. 2008). Credit unions have been described by the European Commission as a tool for the prevention of financial exclusion. Financial exclusion refers to a process whereby people encounter difficulties accessing and/or using financial services and products in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society to which they belong.



**Figure 1.** Financial service providers. Source: European Commission.

Figure 1 shows that credit unions are listed among the range of alternative financial services providers. 'Alternative' refers to organisations paying special attention to marginal segments of society. Ensuring access to finance for groups

of people otherwise excluded from the mainstream of civil and economic activity is essential. Bill Drayton (2006), chair and founder of Ashoka, a global not-for-profit organization devoted to developing the profession of social

entrepreneurship, has concluded that although it is normal for support areas like finance to lag behind change in the operating areas they serve, the emergent citizen sector is now at significant risk unless it can quickly engineer major structural changes in both its institutional finance sector and the broad grassroots sources of support in its post-breakeven zone (Drayton, B. 2006).

A proactive credit union system is minimising the above-mentioned risk through their activities for achieving structural change in the country's financial sector, with particular emphasis on creating access to finance for civil society actors. Meaningful development however, does not only depend on the existence of a facilitating environment but also requires certain other factors to be in place, notably usable physical resources, human and social capital, and appropriate external support (Nel, E, Binnis, T. and Motteux, N. 2001).

### Development of Credit Unions in Latvia

The case of credit unions in Latvia has proved that education and training of credit union members results in the active involvement of residents in social and economic activities of their community. As credit unions were generally started by people who did not have previous experience in organising financial institutions, credit union supporters had to actively promote the education of groups of people who wanted to start, together with the general public, in economic, social, democratic, and mutual self-help principles. Such a form of social enterprise as credit unions, reasonably promoted and fostered, potentially could play an important role in Latvian society by helping low income people to organise access to necessary financial services.

Although Latvia has been a member of European Union since 2004, a process of socioeconomic segregation is on-going in

society. The Gini index, reflecting the polarisation of material welfare, shows how unequally income is distributed within the country. Thus, the Gini index at the end of 2009 was 0.37, when the average for the European Union in 2008 was 0.31 (CSB, 2009). The Gini value of 0 represents income being distributed absolutely equally; in contrast, the value of 1 demonstrates there is marginal inequality, meaning that all income has been received by a few members of the society. The constant increase of the Gini index in Latvia proves that inequality in income distribution is continuing and the gap between the wealthy and the poor is increasing. Additionally, another indicator that should be considered to describe the scope of low income members of society is the 'at-risk-of-poverty' rate. This indicator, according to Eurostat, does not measure wealth or poverty, but low income in comparison to other residents in the country.

The annual national at-risk-of-poverty threshold is set at 60% of the national median income per equivalent adult. According to Community Statistics on Income and Life Conditions (EU-SILC, 2010), in Latvia the proportion of the population living under the poverty risk threshold in 2008 was 26%, being the highest within the European Union. Under such circumstances it is very important to assist individuals in communities to become involved in civic and entrepreneurial activities that are aimed at providing the necessary services to themselves or generating additional income. Within the European Union generally, Latvia has the highest at-risk-of-poverty rate. In addition, the at-risk-of-poverty threshold in Latvia is the seventh lowest and it exceeds this indicator not only in Romania and Bulgaria, but also in Poland, Lithuania, Hungary, and Slovakia.

The at-risk-of-poverty rate in 2008 remained at the level of 2007 - 26% (fig. 2). It means that slightly more than 500 thousand, or one-quarter of the population were subjected to the risk of poverty.

At-risk-of-poverty rate in Latvia 2004 - 2008

(per cent)

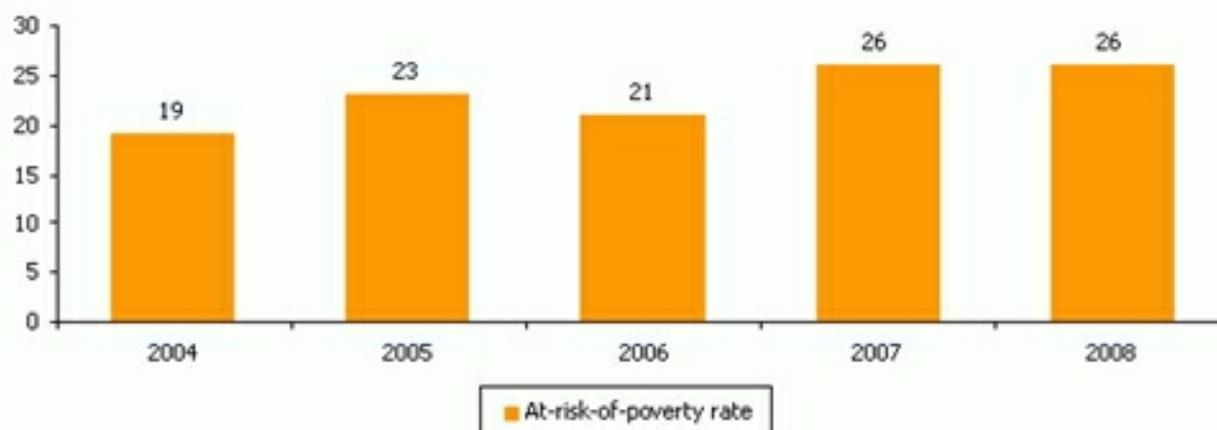


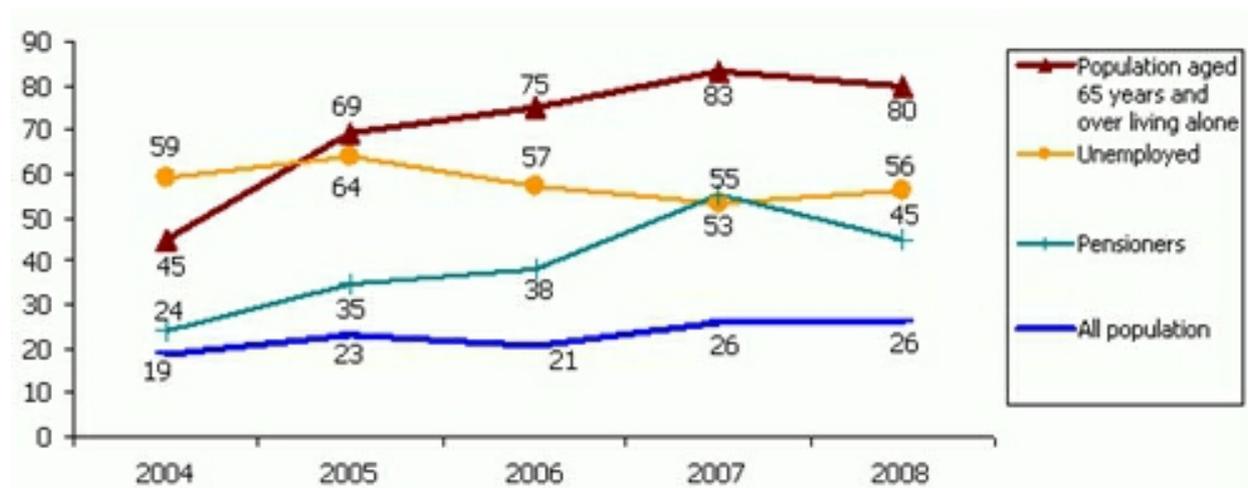
Figure 2. At-risk-of-poverty rate in Latvia, years 2004 - 2008. Source: SCB.

In 2008 the at-risk-of-poverty rate was the highest (80%) among the population aged 65 and over living alone (fig. 3). According to 2007 data the poverty risk of these persons exceeded the average indicators of the European Union by

2.7 times and was the highest among the member states. The next group subjected to a high at-risk-of-poverty rate are the unemployed. Moreover, their at-risk-of-poverty rate in 2008 has grown by 3 percentage points.

## At-risk-of-poverty rate among various population groups in 2004 - 2008

(per cent)



Source: CSB

**Figure 3.** At-risk-of-poverty rate among various population groups of Latvia in 2004 - 2008.

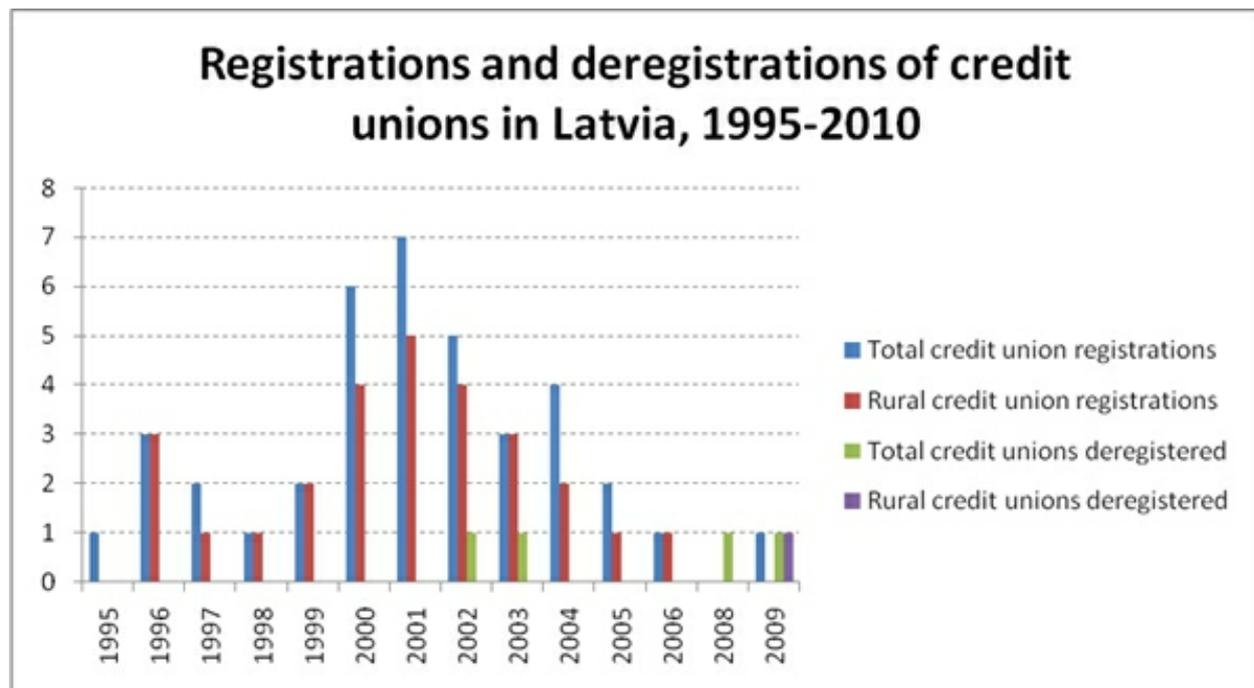
The above information demonstrates that poverty risk in Latvia is very high and varies between different population groups. According to the data of the Central Statistical Bureau (CSB), in 2008 there was a trend of young people being more likely to suffer from a declining level of economical activity and increasing unemployment rate. The poverty risk between people aged from 18 to 24 has increased by 3 percentage points and reached 19%. It was the highest level during the last five years. By promoting social entrepreneurship the poverty risk could be decreased, because one of the main aims of social enterprise is to solve social and economical problems in society.

Members of a credit union need to share a 'common bond'. The Law on Credit Unions of the Republic of Latvia defines the main function of a credit union as being the development of the ability of its members to act jointly in order, on the basis of mutual assistance and principles of self-governance and promotion of thrift, to set up credit resources to satisfy their personal, economic, and everyday needs, thus promoting their well-being. The law also provides for the common bond of a credit union to be defined according to territorial, employment, and principles of mutual interest. In practice, credit unions have united their members according to the territorial principle and the principle of mutual interests. Thus, since 1995 Latvia has acquired important experience in organising savings and credit

cooperatives, or credit unions. for members of large and strong trade unions and some non-government organisations as well as residents of rural communities. The main features of the operating credit union network in Latvia are:

- Two main groups of credit unions - community and trade union-based credit unions;
- Low loan delinquency ratio;
- Good image within communities;
- Leaders - elected officials from credit union members;
- Support from local government deputies;
- The best marketing principle of "each member brings a new member";
- Easy loan granting process;
- Close link between members.

Figure 4 illustrates the dynamics of credit union registration and deregistration. There were no changes in the number of operating credit unions in 2010.



Source: own

**Figure 4.** Registrations and deregistration of credit unions in Latvia, year 1995 - 2010.

During the time period from 1995 to 2010 there were 38 registered credit unions, including the 27 registered in rural regions. Credit union registration is the date when it is entered into the Republic of Latvia Enterprise Register and thus officially becomes a legal entity. Prior to registration a newly establishing credit union has to obtain a special operating permit or licence from the Financial and Capital Market Commission, which is responsible for regulating and monitoring the functioning of all participants in the financial and capital market. According to data of the Financial and Capital Market Commission, the number of credit unions has increased from only one in 1995 to 34 by the end of year 2010. By the end of year 2010 there were 34 operating credit unions in Latvia, with a total membership over 25,000 people and total assets exceeding 11.5 million Euros. However, these are strongly concentrated in trade union-based urban credit unions. Twenty-five credit unions are in rural regions and they represent 74 percent of the total number, thus proving the need in rural communities for their services is higher than in urban areas. Although rural credit unions represent nearly three-quarters of the total number of credit unions, they represent only 26 percent of total membership and 23 percent of total assets of the credit union movement.

By supporting credit union development, trade unions have taken the initiative to protect the social guarantees of employees and have succeeded in that very well. The two biggest credit unions, respectively uniting members of the Railroad & Transportation Trade Union and the Latvian Seafarers' Union of Merchant Fleet, together represent nearly 60 percent of total credit union membership and 77 percent of total assets. Starting their credit unions on the basis of already strong and well-functioning trade unions was a key success factor for the development of their credit unions. At the same time, the promotion of 'self-help' efforts of citizens to organise

affordable credit services is even more essential in the rural areas of Latvia, where people have become socially passive, even depressed. Access to finance is more challenging for people who reside outside big cities and the provision of financial services to people who are not considered as good clients of banks demonstrates the social nature of the entrepreneurial activity of credit unions. Credit unions have raised people's self-confidence and belief in their own abilities. According to information from the Association of Cooperative Credit Unions of Latvia (LKKSS), rural credit unions foster participation of their members in the local economy, not only by pooling their financial resources but also by investing their time and skills, thus creating considerable social capital. Just working on establishing a credit union energizes people and makes them believe in themselves. It is also a tremendous investment in democracy-building. Debates, voting, decision-making all take place in a collegial atmosphere, where people learn new social skills. Therefore the role of credit unions in the development of communities should be judged not so much by such quantifiable measures as assets and membership, but the opportunity they provide for people to become engaged in the development of their communities. One of the founders and a leader of the first rural credit unions, who was at that time the head of local government of the community, recalls (Gange, A. 2004): "The idea to start savings and credit as a tool to support residents' economic activity came to us in 1994, when everything old was still breaking down and there was nothing new created instead. Economically it was a very hard situation. The main goal was to encourage people, to let them build trust in themselves. We had to introduce such a support mechanism that would help them to recover, and to look for new ways of activities, to adjust to the circumstances, to take responsibility for themselves, to plan for their lives. And we succeeded. In Taurene, as well as other communities where credit cooperatives were established, entrepreneurship was more

stable, and people economically more active. All this proves the savings and credit union has justified itself."

Another story exemplifying the positive role of cooperatives in fostering small entrepreneurship in rural areas is the case of the credit union "Dzese Plus". In 1997, seventeen farmers of the Liepaja region, a coastal community in the west of Latvia, decided to revive a milk processing enterprise that was close to going bankrupt by reorganising it into the form of cooperative. Within the following seven years of operation, due to their joint efforts the cooperative became so successful that its members decided to start another cooperative: a credit union. The purpose of starting the credit union was to help the members of the milk processing cooperative to resolve access to finance for development of

their farms. Another founder and leader of a rural credit union admits the credit union's special approach, that puts the needs of people before it's profit, allows it to set lower rates on loans making this start-up capital more available for new entrepreneurs. This by itself gives people an opportunity to increase their welfare and creates new jobs and contributes to society in many other ways (Euroweek, 2010).

As shown in table 2, over half of the membership consists of the so-called 'marginal groups' of society. Marginal or sensitive groups of people include young people who find it difficult to obtain employment because of their lack of experience, as well as those of pre-retirement age, that is people older than 55, and senior people over 65.

**Table 2.** Rural credit union member distribution by age

Age group(years)	Percent of total membership
18 - 30	19
31- 50	42
51 - 65	25
65 <	14

Source: Own, based on data from member survey.

LKKSS statistics reveal that the average assets of a rural credit union is close to 68,000 Euros. At the same time, assets of an average smaller credit union barely exceeds 9,000. About half of rural credit unions do not have high levels of the core capital contributed as shares by members. Their officers are generally unpaid volunteers and staff levels are very small. Most of the funds used for loans are obtained from member depositors, for which they pay an interest cost. Being a business, credit unions also have to pay operating

expenses, including interest, rent, salaries, taxes, regulatory costs, deposit insurance, etc. The imbalance in the distribution of urban and rural credit is a prime reason to give more attention to the development of rural credit unions. Therefore, for the future it is suggested by authors for new start-ups to consider achieving at least the financial performance level as shown in the pro forma balance sheet for the first three years of operation (fig. 5).

Example Credit Union				
Pro Forma Balance Sheet (LVL*)		Year 1	Year 2	Year 3
	note			
<b>Assets</b>				
Cash in Bank		2,317	986	1,814
Loans to Members	1	22,246	64,692	67,907
Fixed Assets		500	500	500
<b>Total Assets</b>		<b>25,063</b>	<b>66,178</b>	<b>70,220</b>
<b>Liabilities</b>				
Members' Savings	2	24,000	43,200	57,600
Borrowings	3	0	19,500	6,800
		24,000	62,700	64,400

Equity				
Members' Shares	4	2,500	4,500	6,000
Members' Reserve Contribution	5	1,250	2,250	3,000
Retained Earnings		-2,688	-3,272	-3,180
		1,063	3,478	5,820
Total Liabilities & Equity		25,063	66,178	70,220
*1 EUR = 0.7028 LVL				
note				
1	Calculated as the amount required to earn enough income to cover operating costs (with the exception of Y1). 75% in personal loans at an interest rate of 12% per annum and 25% in microenterprise loans at an interest rate of 15% per annum.			
2	Calculated at an average amount of LVL6 per member per month; Y1 250, Y2 450, Y3 600.			
3	Calculated as the difference between projected loans and savings. Interest cost at 8% per annum.			
4	Calculated at LVL 10 per member.			
5	Calculated at LVL5 per member.			

Source: own.

**Figure 5.** Pro forma credit union balance sheet.

The development of credit unions in Latvia can be characterised also by the penetration rate. According to WOCCU, the penetration rate represents the degree to which a credit union has succeeded in obtaining the participation of its community population and it is calculated by dividing the total number of reported credit union members by the economically active population of the community aged 15-64 years. The WOCCU Statistical Report of 2009 shows the penetration rate for Latvia was 1.6 percent, while for Europe it was 3.6 percent. At the same time, the situation in rural areas, where credit unions have gained support from local community officials and individuals, the penetration rate is much higher. For example, in the Cesis region, being one of the 13 rural regions where there are credit unions, the penetration rate is 5.8 percent.

## Discussion and Conclusion

The Latvian credit union network follows the geographical and demographic peculiarities of the state. This means the credit union network can be divided into two main groups: urban credit unions, mostly in the capital Riga, and those in rural areas. Urban credit unions are based on trade union principles and their membership is based on trade union organisations. The imbalance in development between Riga and the countryside, is a prime reason to give more attention to the development of rural credit unions. In rural areas credit unions are mostly connected with communities or

groups of communities. In urban credit unions the most popular group of loans is for consumption. In rural areas credit union members mostly borrow for both consumption and entrepreneurial needs, thus playing an important role also as a microfinance institution supporting community economic activity. The penetration rate of the Cesis region proves that there is a potential for development for rural credit unions of Latvia fulfilling also the role of social enterprise for the benefit of society in large. In order to increase the development of credit unions penetration the support from local community officials and individuals and targeted actions are needed both for the urban and rural credit unions. The further research about the benefits of credit unions as a social enterprise in society is required.

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