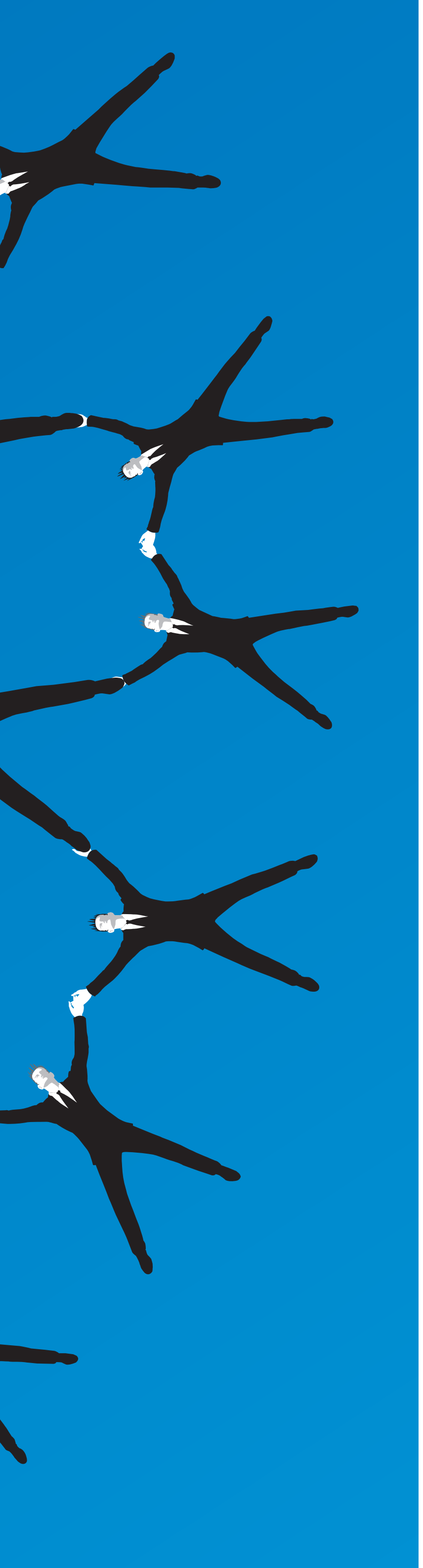
TIAS

SCHOOL FOR
BUSINESS AND SOCIETY

# EUROPEAN CO-OPERATIVE BANKING

## ACTUAL AND FACTUAL ASSESSMENT

Hans Groeneveld



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# Foreword from the EACB and TIAS

*3 March 2015* - **This publication aims to sketch the current state of affairs in European co-operative banking for a broad audience, e.g. co-operative bankers, policy makers, regulators and the general public. It is prepared by TIAS School for Business and Society (henceforth TIAS), with support from the European Association of Co-operative Banks (EACB) in Brussels. TIAS is the Business School of Tilburg University and Eindhoven University of Technology in The Netherlands, focusing on education and research for professionals employed in both profit and not-for-profit organisations.**

The main objective of the report is to disseminate and analyse facts and figures of European co-operative banking groups objectively. This is highly important, especially in light of present economic and financial perspectives, structural developments in banking and eminent changes in banking supervision and regulation.

We sincerely hope that this factual publication will contribute to greater understanding and increased awareness of the co-operative banking model. Both aspects clearly touch upon recent academic and policy-oriented discussions on the nature and role that banks do, can and should play within modern financial systems. Herewith, we would like to point out to policymakers, scholars and supervisors that banking comes in many guises. Finally, it goes without saying that any comments are welcome. We are also more than pleased to provide additional information and further clarifications.

EUROPEAN ASSOCIATION OF CO-OPERATIVE BANKS

TIAS SCHOOL FOR BUSINESS AND SOCIETY

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# Executive summary

**Since the onset of the Great Financial Crisis in 2007, not-for-profit banking models have attracted more policy-related and academic attention than in the preceding decades. Paradoxically, the emerging academic and policy interest stemmed from the 'discovery' that not-for profit banks weathered the initial financial and economic storms in the time period 2007-2010 relatively well. In particular, co-operative banks showed a remarkable resistance and resilience, and hardly needed state support (Groeneveld, 2011). Many analysts and academics have attributed this achievement to the implications of their specific business model (see Ayadi, 2010 et al.).**

Objectively, co-operative banks stand out from other banks regarding their ownership structure and business orientation. Customers have the possibility to become a member of local co-operative banks. Via a representative democracy, members participate in strategy, control, supervision, policy and decision making. Co-operative banks are accountable to their members, have a not-for-profit mission and are consequently able to apply a long-term horizon. These factors are supposed to have led to a focus on retail banking with close links to the real economy, a tendency to adopt less risky strategies, the formation of internal solidarity mechanisms, and a relatively high capitalization (Birchall, 2013).

But these observations relate to their accomplishments a few years ago. Although the pressure from the initial financial crisis beginning in the summer of 2007 has clearly abated, this time period remained tumultuous in economic and financial terms due to subsequent turbulent events in Europe. Against this background, this publication reviews the recent position and overall performance of fourteen co-operative banking groups in ten European countries[1] in the period from 2011 to 2013, on the basis of a range of selected indicators.

The report finds that the co-operative banking groups under review were not immune to the chilly economic climate and great turmoil in Europe after 2010. In 2013, their aggregated total assets and loan portfolio shrunk slightly, which is historically quite exceptional. However, this overall decline is modest compared to the decrease in total assets and outstanding loans to the non-financial private sector of all other banks in the same European countries. In 2013, total assets of all other banks dropped by almost 10 per cent. The European Central Bank (2014, p. 5) states that this is attributable to: *'on-going balance sheet repair and the related deleveraging of (non-core) assets, with the reduction in derivative positions accounting for a large part of the total balance sheet shrinkage.'* In these economically and financially difficult times, co-operative banks were able to further expand their membership base and domestic market positions. They attracted significantly more new deposits, resulting in a rise in their overall deposit market share. By retaining solid deposit bases, potential liquidity risks and funding costs are mitigated.

Financial indicators like the tier 1 ratio and return on equity also point to a less volatile performance and development of co-operative banking groups. In 2011-2013, their average return on equity was significantly higher than that of the entire banking sector. In fact, calculations in this document reveal that the return on equity of all banks was negative in 2012, whereas co-operative banking groups still recorded an average return on equity of slightly more than 2 per cent. Finally, the cost to income ratios hardly differed between co-operative banking groups and the entire banking sector in the period under review.

[1] Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (entire finance Group belonging to the German Volks- und Raiffeisenbanken), Austrian Volksbanken Group (Austria), Raiffeisenbanken Group (Austria), Associazione Nazionale fra le Banche Popolari (Italy), Federazione Italiana delle Banche di Credito Cooperativo-Casse Rurali ed Artigiane (Italy), Unión Nacional de Cooperativas de Crédito (Spain), Crédito Agricola Financial Group (Portugal), Rabobank (The Netherlands), Raiffeisen Switzerland (Switzerland), Nykredit (Denmark), Crédit Agricole Group (France), Credit Mutuel Group (France), BPCE (France), OP-Pohjola Group (Finland).

All in all, this report corroborates the findings of earlier studies; European co-operative banks are distinct players in the European banking industry. Each year, their overall performance differed in terms of efficiency, profitability and risk compared to the complete banking sector. Their stakeholder-oriented governance fosters a predominant orientation towards retail banking which demonstrably results in a moderate risk profile and close links with the real economy and local communities. This observation underscores the valuable contribution of various competing models in banking to diversity and consequently financial stability. Diversity in ownership and business orientation leads to diversity in risk appetite, management, incentive structures, policies and practices as well as behaviours and outcomes (see Butzbach and Von Mettenheim, 2014). It offers greater choice for customers and society through enhanced competition that derives in part from the juxtaposition of different business models. Hence, it is not argued that the co-operative banking model is superior to other models[2]. Each type of banking organisation is obviously faced with general and specific issues and has advantages and disadvantages. This publication merely advocates for a healthy and meaningful mix of different banking models in various markets.

[2] Admittedly, some individual co-operative banking groups faced considerable difficulties in either their domestic or international activities in 2011-2013, but hardly in their co-operative core (i.e. at local or regional co-operative banks).



# A concise historical overview of co-operative banks

**All present co-operative banking groups have a long and rich history. Most co-operative banks were established in the 19th century in response to the problems that small urban and rural businesses had in accessing affordable financial services. They were able to grant loans to these 'excluded' groups, because members provided funding or stood bail and were therefore involved in the decision-making and credit granting process. Initially, loans were extended exclusively to members. Membership was not a pre-requisite for placing savings at co-operative banks. Local credit co-operatives did not aim at maximizing short term profits, but profits were necessary for further growth and were for the larger part retained and added to the capital base.**

Over time, co-operative banks have modernized. They have restructured and the majority of local co-operative banks developed into national (network) organisations. Co-operative banking groups became active in other fields of financial services such as insurance or leasing. The increasingly level of domestic integration was partly motivated by regulatory requirements or the necessary realisation of economies of scale and higher efficiency levels to stay innovative and competitive. Subsequently, quite some national organisations transformed into internationally active banking groups. Some co-operative banking groups have sold a part of their business activities to investors or became partly listed, thus gradually transforming into a hybrid type of financial co-operative.  In the course of time, many co-operative banks also started to serve non-members, particularly private individuals who needed current accounts and/or home loans.

The present co-operative banking groups differ with respect to the degree of centralization and integration within the networks, the size and focus of international activities, and the design of the co-operative governance with member authority. In most cases, banking regulation reform and pressures of competition have led to a centralisation of strategic and operating functions and processes. This has resulted into multiple tier networks, which vary from loose associations to highly integrated groups. The shared second-tier operations comprise wholesale divisions and provide economies of scale and reduce costs, while retaining local relational banking and institutional foundations in social and political networks. In addition, many second-tier network organisations are responsible for the execution of internal solvency and liquidity mechanisms and/or internal deposit guarantee schemes to ensure the overall stability of the network. To perform these tasks adequately, the APEX institutions (i.e. the central institution of local or regional co-operative banks) are often endowed with monitoring and control functions as defined in the Capital Requirements Regulation. These monitoring devices usually exert a strong disciplinary influence on member banks (and their management), apart from the intrinsic peer pressure within the network[3].

[3] In Finland, The Netherlands and Portugal, the APEX institution is officially responsible for the delegated supervision over the local banks on behalf of the external banking supervisors. However, the affiliated local co-operative banks are independent legal entities with an own banking license.



# Data description

**Acknowledging that differences between individual co-operative banking groups exist, this report presents an overview of the overall position and performance of fourteen European co-operative banking groups in 2012 and 2013 (see footnote 1). To this end, comparable consolidated and/or aggregated data for key co-operative and financial indicators of individual co-operative banking groups are calculated by TIAS[4]. In most cases, individual figures were derived from public sources. In some instances, data were composed upon request by co-operative banks for TIAS.**

Nevertheless, judgment was required to categorize the various balance sheet items (e.g. loans, deposits, equity) in order to obtain comparable data for European co-operative banking groups. Indeed, accounting conventions and terminologies as well as the detail of disclosure seem to differ somewhat across co-operative banks. The constructed comparable data are subsequently used to calculate averages for all co-operative banks together. Hence, we do not look at individual co-operative banking groups, since we aim to provide a general picture. When appropriate, these data are contrasted with aggregated data for entire banking sectors in these ten European countries. The latter figures are collected from national supervisory authorities as well as the European Central Bank (ECB) using similar definitions.

[4] For the non-euro countries in the sample, all items were converted into euro at the exchange rate prevailing at the statement date.

**Table 1: Diversity in European co-operative banking (2013)**

| | Total | Average | Median | Minimum | Maximum |
|---|---|---|---|---|---|
| Balance sheet in EUR billion | 6,825 | 488 | 249 | 13 | 1,706 |
| Number of members | 54,945,188 | 3,924,656 | 1,764,000 | 291,000 | 17,712,774 |

Source: TIAS calculations.
Note: the data set comprises fourteen co-operative banking groups in ten European countries.

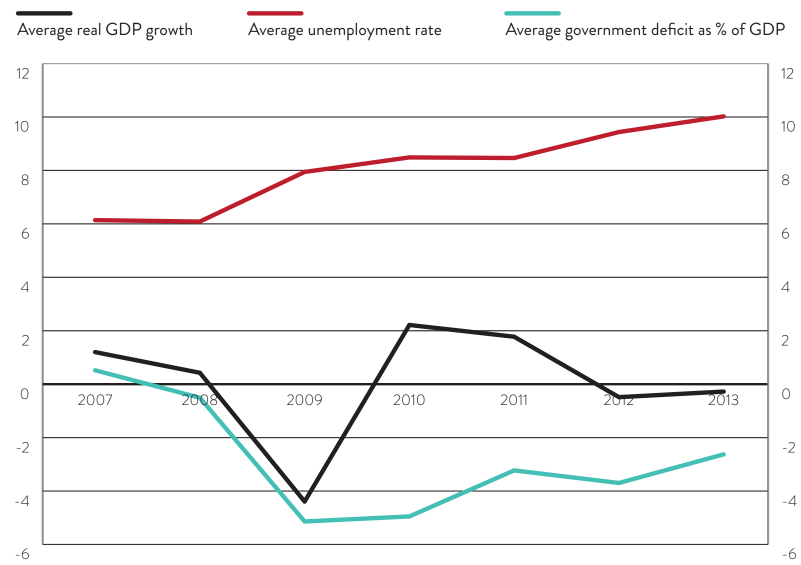
Table 1 illustrates the great diversity in European co-operative banking. The first row reports aggregated information on total assets of the fourteen co-operative banks included in this publication. The second row displays similar statistics for members. In terms of total assets, the ratio of the largest co-operative banking group to the smallest is around 130, which accentuates the large difference in size. The average balance sheet total amounted to EUR 488 billion in 2013. The disparity between the largest and smallest co-operative bank measured by members is much smaller. The largest co-operative bank has about 60 times more members than the smallest. These differences in size have grown over time due to many different reasons. Given that all co-operative banks already exist for a very long time, size is not by definition a determining factor for viability in itself. This might, however, change in the future as a result of developments in competition, society, technology and supervision. These factors could alter the environment for co-operative banks fundamentally.



# General economic environment

**For an adequate and accurate interpretation of recent developments in co-operative banking, one has to take the overall economic situation into consideration. Figure 1 displays the average real GDP growth, the unemployment rate and the government deficit as a percentage of GDP in the countries under review. A somewhat longer time horizon has been applied, because economic developments generally impact banks with a time lag and/or for a prolonged period of time. Of course, banks also exert a clear impact on these variables, but the issue of causes and effects is beyond the scope of this report.**

**Figure 1: Development of key economic variables in ten European countries (average)**




*Source:* TIAS calculations based on data from Eurostat and the European Commission.
The lines symbolize the average values of the displayed variables in ten European countries.

The last five years have been a roller coaster from an economic point of view. The deep recession of 2008-2009 was followed by two years of moderate economic recovery. This economic upswing was largely manufactured by increasing government expenditures or specific tax relief measures, which in turn resulted in rising government deficits. At the same time, concealed structural weaknesses in the Eurozone came to the fore, and governments embarked on substantial austerity programs. Together with disruptions in national financial systems, this pushed the ten European countries back in a – milder – recession again. The unemployment rate and the number of failures in the SME sector have followed a dramatic pattern as well. From around 6 per cent in 2007, the average unemployment rate jumped to 10 per cent in 2013. In some countries, the unemployment rate currently has double digits, with Spain at the top of the list. In the meantime, the European Central Bank took extraordinary monetary steps to safeguard financial stability in the Eurozone. The European Union undertook radical institutional reforms for banking supervision and regulation. The formation of the Banking Union and the transfer of banking supervision from national supervisory authorities to the European Central Bank in November 2014 are cases in point[5].

Since co-operative banking groups are measurably primarily focused on the real economy (Oliver Wyman, 2014), these economic developments are highly relevant for them. It goes without saying that many of their members and customers were confronted with heavy headwinds[6].

[5] This report does not deal with the implications of changes in supervisory and regulatory regimes for co-operative banks. For an informative overview of these issues, the interested reader is referred to the Annual Report 2013 and/or the website of the European Association of Co-operative Banks.

[6] Mooij and Boonstra (2012) feature a collection of case studies of co-operative banking groups in different times of crisis.



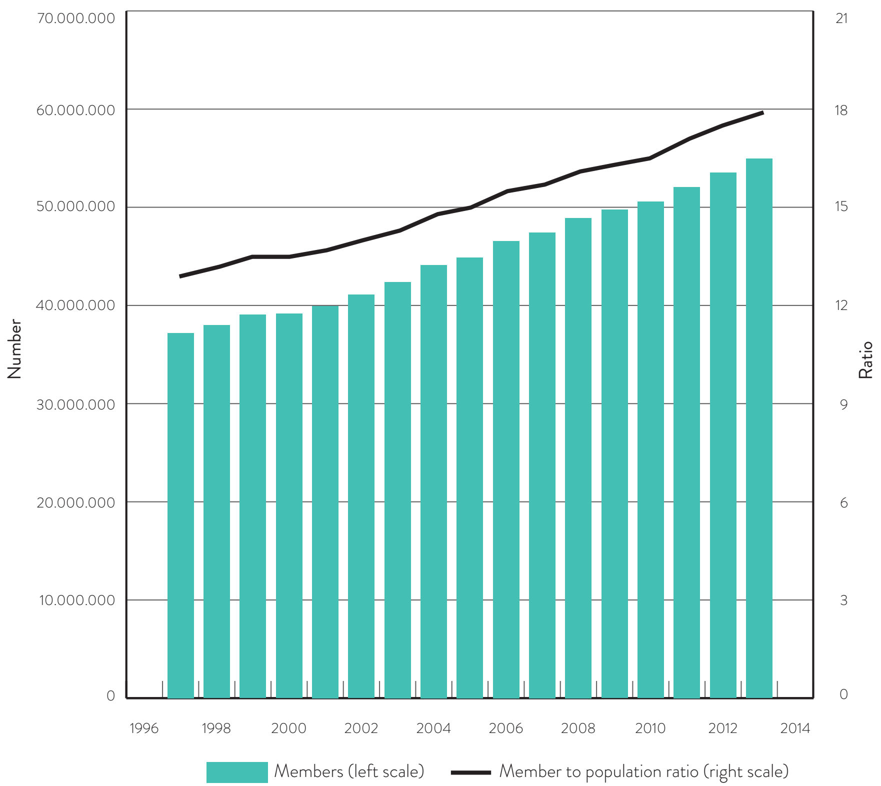
# Members

**Although diversity in co-operative banking exists, co-operative banks share important common features. One characteristic is that a customer of a local bank can become a member/owner of this bank. It is generally stated that without members there cannot be a co-operative, and a co-operative with voiceless members cannot be a co-operative either.**

It is commonly acknowledged that members and their elected representatives are an essential asset and actually embody the legitimacy for co-operative banks (EACB, 2007). Membership is open and generally based on the 'one member, one vote'-principle. Members can influence the course of their local bank, and are usually involved at several levels in the organization (local, regional and national). In the early days, membership was compulsory in order to be eligible for obtaining a loan from a local co-operative bank. Many co-operative banks abolished this requirement a long time ago, implying that the development of the number of members can now be interpreted as an implicit indication for the attractiveness and popularity of co-operative banks.

Figure 2 shows the development of the number of members and the member-population ratio since 1997. Strikingly, the number of members has increased continuously. Member growth does not appear to differ significantly between years of strong economic growth and financial stability and between years of economic slack and financial instability. The total number of members rose from around 37 million in 1997 to approximately 55 million in 2013, which equals a growth of almost 50 per cent. On average, the member base grew at an annual growth rate of 2.5 percent since 1997. In 2012 and 2013, European co-operative banks welcomed almost three million new members. In relative terms, the average member to population ratio showed an upward trend; the ratio rose from 12.9 in 1997 to 17.8 in 2013. The increase signals trust and confidence of customers in co-operative banks. Indeed, clients are presumably not very eager to become a member of local co-operative banks if the level of trust and satisfaction would be low.

**Figure 2: Number of members and member to population ratio**



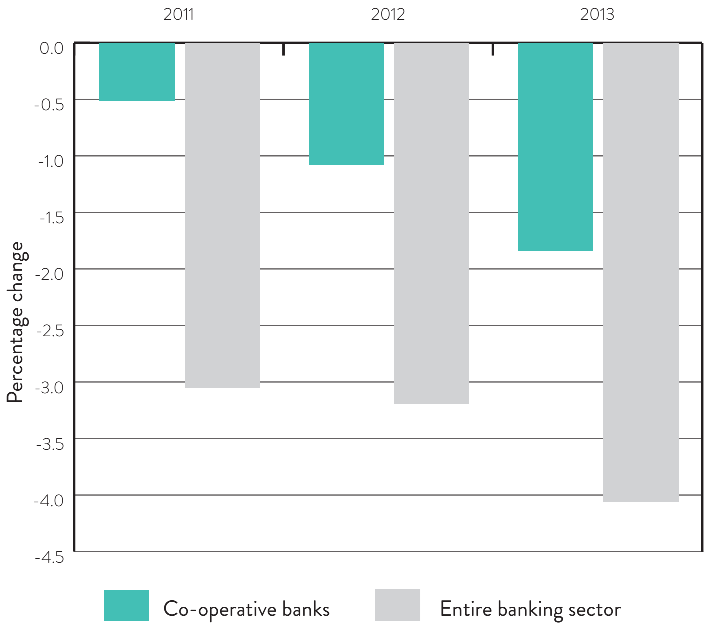

*Source:* Calculations by TIAS based on data from co-operative banking groups and national demographic statistics.

# Number of local banks, branches and employees

**The number of independent local or regional co-operative banks has diminished considerably over time. In 2011-2013, this trend continued. The number of independent co-operative banks dropped in every country and in total by around 170 to about 2,970 in 2013. From public sources, it appears that this decline is mainly due to altering customer preferences for distribution channels, IT developments, larger homogeneous geographical areas justifying larger local banks, and efficiency considerations.**

A similar pattern is discernible in the number of domestic branches of co-operative banks and all other banks. Between 2011 and 2013, co-operative banks reduced the number of branches by almost 3 percent, whereas all other banks closed down approximately 8 percent of their branches. The process of rationalization and resizing is partly attributable to IT developments in banking and also reflects conjunctural factors, such as pressure to reduce staff costs and overlapping branch networks. Regarding IT developments, customers are not only increasingly using all kinds of virtual channels to perform their banking activities (i.e. mobile banking), but are also increasingly participating in virtual communities matching their personal and/or professional interests.

**Figure 3:** **Percentage change in number of branches in the co-operative and entire banking sector**




*Source:* Calculations by TIAS based on figures from co-operative banks, ECB and the Swiss National Bank.

The latter trend poses a challenge for co-operative banks, which have frequently stated to cherish physical proximity to their members and local communities. This way, they have traditionally been able to build and maintain close connections with local communities. By definition, the closure of branches (or mergers between local banks) increases – literally and figuratively – the distance between members and local banks and reduces the number of elected members in formal governance bodies. In that context, various measures have been initiated to enhance the involvement of members in the development of their local bank. Indeed, co-operative banks should substantiate their long standing promise to contribute to a sustainable economic development of local areas together with their members. Fulfilling this requirement simply asks for physical presence and close relationships with local authorities and economic actors.

For the first time in the past decade, employment in the co-operative banking sector declined by about 2 percent to 754,000 employees since 2011. This drop is relatively small compared to the fall in employment in the entire banking sector by 4.5 percent since 2011. In fact, employment in the entire banking sector has diminished in five consecutive years.

# Total assets, loans and deposits

**Balance sheet data for co-operative banks and the entire banking sector (excluding co-operative banks) are provided in table 2. Mirroring turbulent economic and financial developments in recent years, the structure and size of balance sheets of co-operative banks and all other banks are clearly shaped by cyclical and structural developments.**

In 2012, total assets of co-operative banks still showed a moderate increase of around 1 percent, while total banking sector assets (on a consolidated basis) contracted by 2.3 percent. In 2013, co-operative banking assets decreased as well, but to a lesser extent than total banking sector assets. The latter shrunk by almost 10 percent as a result of bank restructuring and resolution processes in some countries as well as reconsiderations of banking business models. The ECB (2014) argues that this reduction is also partly due to shrinking derivative positions and a sizeable cutback in total loans (including customer and interbank loans), i.e. deleveraging processes, by a few large banks.

Regarding outstanding loans as well as loan growth of co-operative banks versus the entire banking sector, a similar pattern emerges. The extension of credit to the economy by co-operative banks differs significantly from that by the entire banking sector in 2012 and 2013. While co-operative banks still slightly extended loans in 2012, the size of the loan book of all other banks declined. Co-operative banks could not escape from the successive economic and financial turbulences as mirrored in the small reduction in their lending activity in 2013. However, loan contraction at all other banks outpaced the loan decline at co-operative banks considerably.

**Table 2: Total assets, loans and deposits of co-operative banking groups and the entire banking sector**

| | | 2012 | | 2013 | |
|---|---|---|---|---|---|
| | | *COOP** | *EBS*** | *COOP** | *EBS*** |
| Total assets | EUR billion | 7,021 | 22,263 | 6,825 | 20,075 |
| | %-change | 0.9% | -2.3% | -2.8% | -9.8% |
| Loans | EUR billion | 3,522 | 7,760 | 3,516 | 7,440 |
| | %-change | 1.3% | -1.1% | -0.2% | -4.1% |
| Retail deposits | EUR billion | 3,216 | 7,889 | 3,267 | 7,977 |
| | %-change | 2.4% | 1.4% | 1.6% | 1.1% |

** COOP = Co-operative Banking Groups* *** EBS = Entire Banking Sector*

*Source:* Calculations by TIAS based on data from co-operative banks, the ECB and the Swiss National Bank.

*Note:* Co-operative banking groups and the entire banking sectors in ten European countries are included in the data (see footnote 1). EBS data do not comprise COOP data. Loans refer to loans to the non-financial private sector. Retail deposits refer to all deposits and savings from the non-financial private sector. Upon close inspection of balance sheet items, we have tried to use comparable definitions for 'loans' and 'deposits' of individual co-operative banks and entire banking systems. Since we have used the same definitions every year, data consistency is guaranteed.

Like loan growth, deposit growth at co-operative banks exceeded deposit growth at all other banks in 2012 and 2013. In 2013, deposit growth decelerated sharper at co-operative banks, but remained significantly above the deposit expansion at all other banks. Overall, the gradual shift towards deposit funding continued in banking. In parallel, the reliance on wholesale funding decreased at all other banks. Lastly, the growth of retail deposits combined with a decline in the extension of credits led to a decrease in the loan-to-deposit ratio of co-operative banks and the entire banking system.

The table points to two other remarkable characteristics of co-operative banking groups. Their asset structure seems to be dominated by loans to the non-financial private sector (more than 50 percent). The ratio of total loans relative to total assets of all other banks amounts to 37 percent. On the liability side, we observe a similar feature. Overall, co-operative banks are funded to a larger extent by retail deposits and to a lesser extent by wholesale funding in comparison with all other banks. This finding indicates that the business model of co-operative banks tends to be more geared towards retail banking activities, which also accords with the outcomes of scarce recent studies.

# Domestic market shares

**The increase in the number of members has translated into rising market shares in national retail banking markets. Since 2011, co-operative banking groups endogenously increased their domestic market shares in retail loans as well as in retail savings. On average, both retail market shares rose by about 0.7 percentage point. This may seem a modest increase, but minor changes in market shares imply shifts of many billions of euros between banking groups.**

The underlying data show that every individual co-operative banking group gained loan market share. In seven European countries, co-operative banks even strengthened their loan market position by more than 3 percent since 2011. Like the increase in the number of members, rising market shares can be interpreted as signs that customers felt relatively more attracted to co-operative banks for a myriad of different reasons.

In addition, table 3 illustrates that co-operative banks have historically maintained extensive branch networks to support the links to their members and local communities. However, the urgency to focus on efficiency improvements in physical networks as a result of mobile banking, contactless payments and integrated cash management is increasing. Despite the recent closures of branches, the average branch market share displays a slight increase since 2011. In 2013, this market share is approximately 10 percentage points higher than that for loans and deposits. It can be concluded that co-operative banks still have a comparative advantage in terms of physical proximity, but also the disadvantage of the resulting cost base.

**Table 3: Average domestic market shares of co-operative banking groups**

| | 2011 | 2012 | 2013 | Change in percentage points (2011-2013) |
|---|---|---|---|---|
| Loans | 26.3 | 26.6 | 27.0 | 0.7 |
| Deposits | 25.7 | 26.1 | 26.3 | 0.6 |
| Branches | 35.8 | 36.6 | 36.3 | 0.5 |

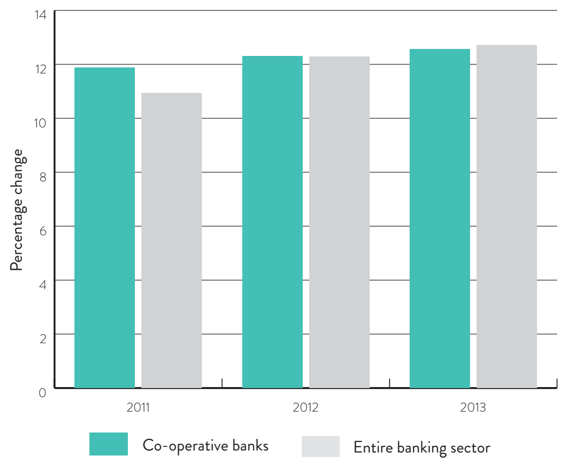
*Source:* Calculations by TIAS based on data from co-operative banks, the ECB and the Swiss National Bank.

# Capitalization

**Figure 4 depicts the average tier-1 ratio for co-operative banks and national banking systems. The ratio mirrors the amount of equity relative to the risk-weighted assets. It appears that the tier-1 ratio of co-operative banking groups was on average almost 1 percentage point higher than the tier-1 ratio for entire banking sectors in 2011.**

In the following years, both co-operative banks and all other banks improved their tier 1-ratio. However, all other banks clearly caught up with co-operative banks, as reflected by the increase from almost 11.0 in 2011 to 12.7 in 2013. The underlying data show that this improvement is caused by both a significant increase in the numerator (i.e. a strengthened capital position) and a considerable decline in the denominator (i.e. a decrease in risk weighted assets, chiefly as a result of the deleveraging process). The overall improvement in bank capital positions points to an enhanced capacity of the entire banking system to withstand possible future shocks and to its ‘being in a better condition’ to reap the benefits of a possible economic recovery (ECB, 2014).

**Figure 4: Average tier-1 ratio of co-operative banking groups and the entire banking sector**




*Source:* Calculations by TIAS based on data from co-operative banking groups, the ECB and Swiss National Bank.

The options for co-operative banks to increase capital are limited compared to those for listed banks. Co-operative banks build the core of their equity base the hard way, through increasing retained earnings. This underscores the importance for co-operative banks to make profits for capitalization, continuity of their operations and further growth. Most co-operative banks cannot issue shares to obtain new or additional capital like investor-owned banks. Some observers argue that this is a disadvantage of the co-operative business model, but this view is rather one-sided. One could equally well assert that this fact urges co-operative banks to have a relatively low risk appetite, because their executives know that capital cannot be easily replenished after substantial losses or write-downs.



# Return on equity

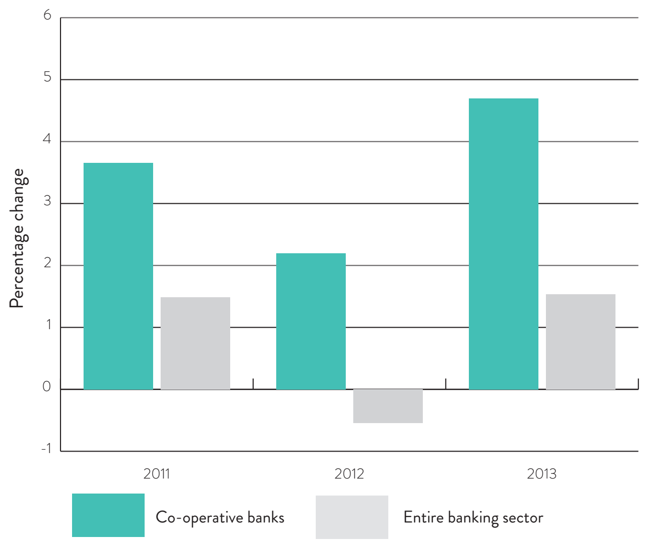
**The return on equity is a widely used proxy for profitability. Earlier assertions fuel the expectation that co-operative banks have below average profitability, as they target customer value maximization instead of profit maximization. However, we find that the average return on equity of co-operative banks has been significantly higher in comparison with that of the entire banking system in the period from 2011 to 2013.**

Based on many standard banking studies, this result seems a paradox, given the non-profit maximizing goals of co-operative banks [7]. We feel , however, that this perceived incongruity precisely reflects the caveat to focus exclusively on measures which are primarily predicated on joint-stock banks and the omission to take into account the underlying characteristics and different orientations of other banks, co-operative banks included.

Turning back to the figures, it appears that the return on equity in the entire banking sector was actually negative in 2012, whereas co-operative banking groups still booked positive returns on their equity. In 2013, net profits to equity recovered, but the ratio for co-operative banking groups was three times higher than the ratio for the entire banking sector (4.8 and 1.5 percent, respectively). This outcome can plausibly be explained by the fact that co-operative banks were on average less involved in restructurings and non-retail banking activities, which have on balance dropped in volumes and revenues. Their focus on retail activities has apparently led to more stable income streams.

[7] For an overview see Berger et al. (2006).

**Figure 5: Average Return on Equity of co-operative banking groups and the entire banking sector**




*Source:* Calculations by TIAS based on data from co-operative banking groups, the European Central Bank and the Swiss National Bank.

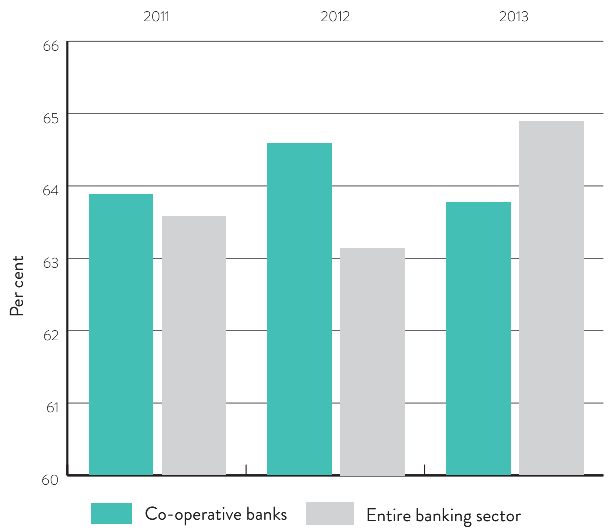
Profits are not the ultimate goal for co-operative banks, but a means to absorb shocks, to invest and innovate for their members/customers, among other things. Profits are also needed for the social goals that co-operative banks pursue on behalf of their members. Hence, the performance of co-operative banks cannot be assessed alone by looking at their financial performance or favourable pricing for members and customers. The pursuance of multiple goals is sometimes difficult to understand for 'outsiders' and leads to misconceptions. In distinguished words, co-operative banks state that they are 'dual bottom line' organisations. Conceptually, it is difficult to measure the social value that co-operative banks create. Although this value is generally tacitly recognized by members and other stakeholders, there is currently no common way of measuring it. It seems that academic research is beginning to tackle this issue. Some sort of dual bottom line accounting – with financial measures on one side and proxies for social impact on the other – would promote the recognition of co-operative banks' distinctive features and role in society.

# Efficiency

**An often used proxy for efficiency is the cost-income ratio, defined as net operational costs divided by net operating income. This indicator relates to the financial performance of banks. If the claims regarding the business orientation and principles of co-operative banks are true, benchmarking of expenses and revenues of co-operative banks against banking sector standards is somewhat misleading. Be that as it may, it is a fact that co-operative banks face competition from other banks with increasingly sophisticated social agendas and less emphasis on profit maximization. Hence, co-operative banks must build scale and operate efficiently to withstand competition.**

Figure 6 displays cost-to-income ratios for co-operative banks (CIcoop) and entire banking sectors (CIebs) in individual countries. CI ratios did not vary significantly between co-operative banks and the entire banking sector. In 2012, the CIcoop was higher than CIebs, but the opposite was the case in 2013. This finding is actually in line with some studies published before the Great Financial Crisis (e.g. Čihák and Hesse, 2007). Moreover, the higher costs of relatively extensive branch networks of co-operative banks are apparently offset by higher revenues. This outcome suggests that they use their assets and capital base in an efficient way.

**Figure 6:** **Average cost-income ratio of co-operative banking groups and the entire banking sector**




*Source:* Calculations by TIAS based on data from co-operative banking groups, the European Central Bank and the Swiss National Bank.

# Concluding considerations

**For all banks, the external environment has changed fundamentally since the 2007-8 crisis. No bank can withdraw from the consequences. Among other things, this remark pertains to changing standards and values in society, technological developments, a negative image of banks, altering consumer behaviour, a stricter supervisory and regulatory framework, higher capital and liquidity requirements, the shift from national to European banking supervision, the formation of the European Banking Union, cybercrime and remaining latent risks in the real and financial economy. Apart from these general challenges, co-operative banks face some specific questions.**

Undoubtedly, the recent crises have modified the context as well as the relationship networks in which co-operative banks operate. Competition has fiercely increased for the traditional core of co-operative banks' business as a result of a strategic reorientation towards retail banking of many other banks and the emergence of new players in financial services, facilitated by IT innovations. At the same time, local identity could lose importance in small firms' and families' financial decisions, in favour of straightforward interest rate or price considerations (Goglio and Alexopoulos, 2014). This trend is reinforced by increasing virtualization in banking, which puts their dense branch networks in another perspective.

In this changing environment, many co-operative banks are exploring options to restore and/or strengthen the connections between co-operative values, members' participation, reciprocal relationships between members and local banks, the commercial and capitalization strategy, and excellence in daily practices. This issue is addressed in many annual reports of co-operative banking groups. They are examining ways to continue operating in proximity to and as relational banks for customers and members, thus enhancing social-economic relationships with their territories and a sustainable development of these areas. At the same time, many co-operative banks are making efforts to achieve a solid position in digital banking services and to express their co-operative identity in knowledge based relationships with members and customers in virtual communities. In short, finding new ways for participating in the rapidly changing real and virtual world is crucial for co-operative banks.

Finally, (representatives of) members are actually endowed to use the significant heritage of co-operative banks for the welfare and well-being of future generations. Indeed, the present capital has been built up by generations of members and can in effect only be passed on to future generations. Therefore, current – board – members and professional executives have to find viable ways to reconcile the necessary transformation and adaptability of co-operative banks to structural and cyclical developments in society and banking, while preserving the core principles and identity of the co-operative organisational form. Fortunately, they have experience in coping with this challenge, since it already exists for more than a hundred years.



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European co-operative banks are distinct players in the European banking industry. Also in recent years, their overall performance differed in terms of efficiency, profitability and risk compared to the complete banking sector. Their stakeholder-oriented governance fosters a predominant orientation towards retail banking which demonstrably results in a moderate risk profile and close links with the real economy and local communities. This observation underscores the valuable contribution of various competing models in banking to diversity and consequently financial stability.