TILBURG UNIVERSITY

European co-operative banks in 2017: a concise assessment

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This research letter presents consolidated financial indicators of 18 co-operative banking groups in 13 European countries for 2017.[2] It is intended for cooperative bankers, policy makers, regulators and scholars. Collectively, co-operative banking groups welcomed 0.9 million new members and maintained solid market shares in domestic retail banking. The comparison between key financial metrics of co-operative banking groups and the entire banking sector shows a mixed picture. On the one hand, some indicators moved in the same direction and converged. This holds particularly for the average tier 1 ratio, the average cost-to-income ratio, and the average return on equity. On the other hand, long-standing differences between co-operative banks and the entire banking industry persisted. Like in previous years, co-operative banks supplied the real economy with more new loans, reported a higher deposit growth, and reduced their branch network and employment to a lesser extent.

Background

In various respects, co-operative banks deviate from banks with other organisational structures. For instance, they do not have external shareholders. Customers of local banks can become members of the co-operative and can play an active role in the governance at the local and/or central level. Co-operative banks are characterised by a dispersed ownership and they build their equity base primarily via retained earnings.

This document records aggregated data of co-operative banking groups which come from public sources or are compiled upon request by some banks. Simultaneously, identical indicators were gathered or constructed from various renowned data bases for national banking systems in which these co-operative banks act. This way, the consolidated performance of co-operative banks can be put into perspective, and moreover, it can be compared to that of entire banking systems. For the non-euro countries in the sample, all figures were converted into euro at the exchange rate prevailing at the statement date.

Continued growth of member base

Members constitute the legitimacy of co-operative banks. In 2017, the member base of co-operative banks expanded by around 0.9 million. Compared to 2016, the number of memberships grew by 1 per cent to 82.1 million. This percentage increase is lower than the long term average expansion of the number of memberships of around 2% per year. In relative terms, one can observe an upward trend. The member-population ratio displays an almost continuous rise. This ratio climbed from 15.7 in 1997 to 19.6 in 2017. The driving forces behind surging number of members are manifold: financial benefits, immaterial advantages, the ambition to participate in internal governance bodies, affinity with the brand, satisfaction with products and services, the pursuance of a dual-bottom approach (i.e. aiming at economic and social objectives), co-operative donations, etcetera. It must be noted that a customer is usually not obliged to become a member if he or she applies for a loan at a co-operative bank.

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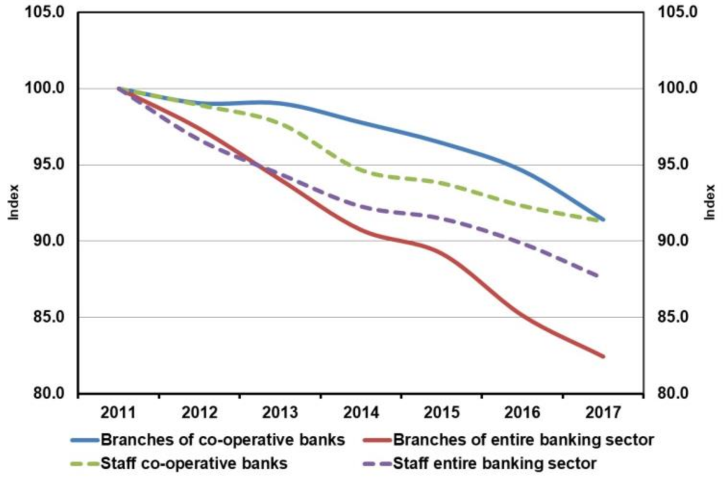
[2] Financial Group of the German Volks- und Raiffeisenbanken (Germany), Austrian Volksbanken Group (Austria), Raiffeisenbanken Group (Austria), Federazione Italiana delle Banche di Credito Co-operativo-Casse Rurali ed Artigiane (Italy), Unión Nacional de Co-operativas de Crédito (Spain), Banco de Crédito Co-operativo (Spain), Federação Nacional das Caixas de Crédito Agricola Mútuo (Portugal), Rabobank (The Netherlands), Banque Raiffeisen Luxembourg (Luxembourg), Raiffeisen Switzerland (Switzerland), Nykredit (Denmark), Crédit Agricole Group (France), Crédit Mutuel Group (France), BPCE (France), OP Financial Group (Finland), Building Societies (United Kingdom), BPS Group (Poland), and SGB Group (Poland).

Mergers caused a decline in the number of co-operative local and/or regional banks of 5.3 per cent to 3,000 in 2017. The entire co-operative branch network shrunk by 3.4 per cent. The longer term trend of consolidation in co-operative banking is visible in figure 1 where branch and employment data are indexed at 100 in 2011. This figure displays the same data for the entire banking sector. Generally speaking, capacity reduction in banking is largely fueled by the need to create efficiency gains, the simultaneous shift towards digitalization and virtualization of financial products and services. However, co-operative banks scaled back their branches and employment to a lesser extent than all other banks in every year recorded. During the entire time span, almost 9 per cent of co-operative banks' branches disappeared, whereas all other banks closed around 18 per cent of their branches. The broken lines show the decrease in employment which displays a more synchronous pattern. Headcount at co-operative banking groups contracted by about 9 per cent, while total bank employment dropped by more than 12 per cent.

Figure 1 Branch and employment development (2011=100)



Source: Own calculations based on data from co-operative banking groups and various supervisory institutions.

Solid domestic market positions

In 2017, co-operative banks gained 0.2 percentage point loan market share, but lost 0.2 percentage point deposit market share (Table 1). The former is currently 1 percentage point higher than the market share deposits. Six years ago, both market shares were almost similar. Hence, the loan market share has increased steadily since 2011, whereas the deposit share remained rather stable.

Table 1 Average domestic market shares of co-operative banking groups

	2011	2012	2013	2014	2015	2016	2017	Change in percentage points (2011-2017)
Loans	21.2	21.4	21.8	22.1	22.2	22.4	22.6	+ 1.4
Deposits	20.9	21.3	21.5	21.4	21.4	21.8	21.6	+ 0.7
Branches	29.1	29.6	30.7	31.4	31.5	32.4	32.5	+ 3.4

Source: Own calculations based on data from co-operative banks, the ECB and national supervisory authorities.

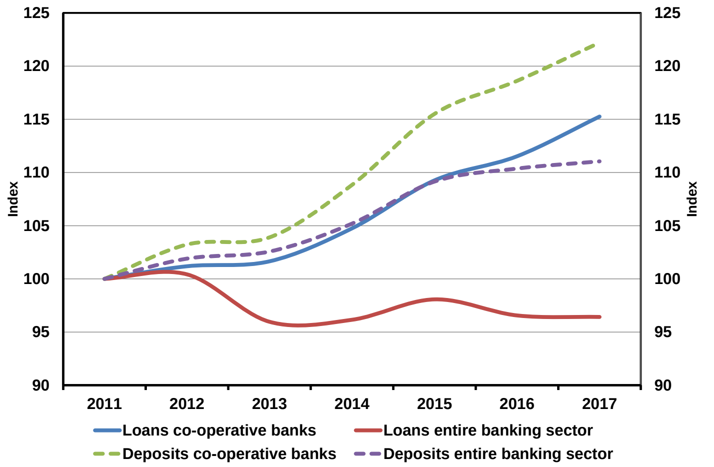
The branch market share has always surpassed the loan and deposit market share. This reflects a distinct feature of co-operative banks: they operate with relatively dense branch networks and are physically close to their members. Furthermore, the share of branches owned by co-operative banks rose significantly in recent years, because all other banks shut relatively more branches (see Figure 1). This fact does not mean that co-operative banks are not increasingly shifting from physical to virtual distribution channels for their products and services.

Firm loan and deposit growth

The dispersion between loan and deposit growth of co-operative banks and the entire banking system widened in 2017 (see Figure 2 on page 3). Co-operative banks expanded their loan portfolio by 3.4%, while the outstanding loan volume of other banks contracted a little bit (-0.2%). Credit expansion by co-operative banks has continuously outpaced loan growth of all other banks in the last six years. Since 2011, coop banks granted the non-financial private sector 15 per cent additional loans. By contrast, the entire banking sector curtailed net lending to the real economy by more than 4 per cent.

When interpreting these figures, it must be realised that economic recessions and financial distress, including a sovereign debt crisis, afflicted many European countries in 2011-2013. Amidst these turbulences, co-operative banks were apparently able to ensure credit availability to borrowers. This suggests that they strongly rely on relationship banking. This feature is connected with their local embeddedness, decentralised nature, and member-based governance. Relationship banking is usually considered to be particularly effective in SME financing where long-term credit relationships matter. Co-operative banks did not forsake prudent lending behaviour, since loan loss provisioning was rather limited and net earnings remained robust.

Figure 2 Loan and deposit development (2011 = 100)



Source: Own calculations based on data from co-operative banking groups, national supervisory authorities and/or central banks. It concerns loans and advances to the non-financial private sector, excluding government.

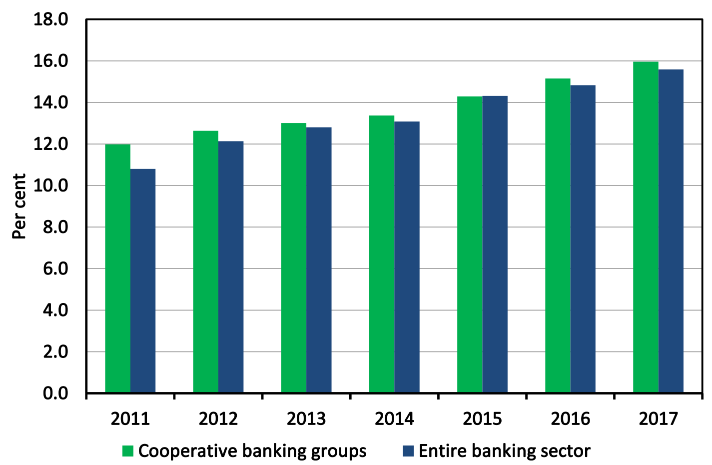
Looking at deposit growth, we can draw analogous conclusions. In 2017, co-operative banks attracted a large volume of new deposits (+3.0%) compared to all banking competitors (+0.6%). Co-operative banks used the acquired deposits to fund their loan growth. Faster deposit growth at co-operative banks has actually occurred ever since 2011.

The described loan and deposit developments resulted in a stabilization of the loan-to-deposit ratios just below 1 for both co-operative banks and all other banks in 2017. Just before the outbreak of the Financial Crisis in 2008, private savings covered around 80 percent of the private loan portfolio of the entire banking sector, whereas co-operative banks operated with a minor ‘deposit gap’ of 3 per cent. In a short time span, all other banks bridged their deposit gap by reducing short-term wholesale funding and restricting lending growth. They now make more use of stable deposit funding. This hints at a partial convergence of funding strategies of both types of banks, which may be partly enforced by new regulatory requirements in recent years.

Surging capital buffers

Co-operative banks and all other banks managed to solidify their capital buffers considerably in 2017; their average Tier 1 ratios rose by 0.6 percentage point. The average Tier 1 ratio of co-operative banks currently stands at 16, which is 0.4 percentage point higher than the average Tier 1 ratio of all other banks (15.6). Over a somewhat longer period of time, the stability of many individual banks has clearly advanced as a consequence of stricter regulatory requirements and a cyclical upturn in the economy.

Figure 3 Average Tier 1 ratios



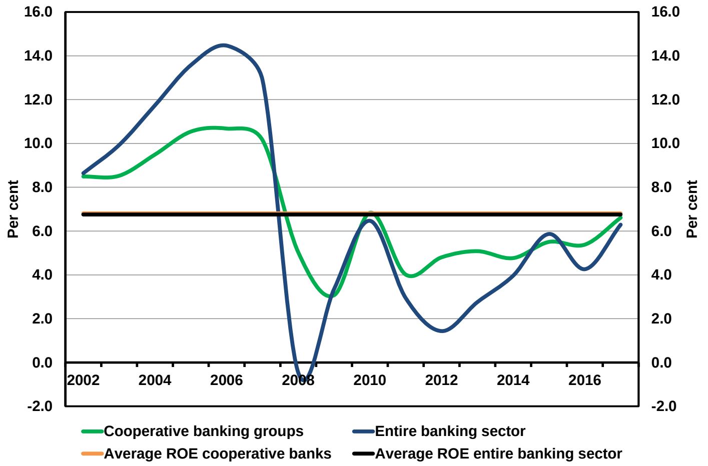
Source: Own calculations based on data from co-operative banking groups, national supervisory authorities and/or central banks.

Before, during and directly after the Great Financial Crisis, the discrepancy between both ratios was much larger as co-operative banks conducted their banking business with higher capital buffers. Since 2012, their average Tier 1 ratio is not significantly different from that of the entire banking industry (Figure 3).

Rising return on equity

On average, all banks benefitted from the economic upswing in their respective countries, despite or thanks to the low interest rate environment. The average return on equity of co-operative banks (ROE_{COOP}) and the collective banking sector (ROE_{EBS}) increased by 1.2 percentage point to 6.6% and by 2.0 percentage points to 6.3%, respectively. As illustrated by the horizontal lines, the average ROE_{COOP} coincides with the average ROE_{EBS} over the period 2002-2017 (6.8%). The actual pattern of both ROEs highlights a much lower volatility of co-operative banks' returns.

Figure 4 Return on Equity of co-operative banking groups and the entire banking sector



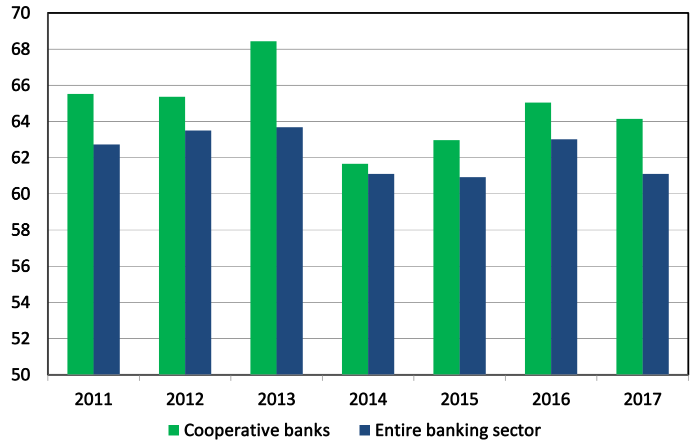
Source: Own calculations based on data from co-operative banking groups, national supervisory authorities, the ECB and World bank.
Note: The orange and black lines represent the average return on equity of respectively co-operative banks and the entire banking sector over the time period 2002-2017.

It is beyond the scope of this research letter to investigate and discuss the causes for the convergence of both indicators since 2014. This development could be due to many factors. However, academics and analysts increasingly suspect that the convergence could partly reflect increased similarities in business models and capitalisation policies of all bank categories, e.g. due to a stronger focus on retail banking, less dependence on wholesale funding, and a more harmonised regulatory and supervisory framework in Europe. If this presumption would be corroborated by in-depth research, this would be good news for the stability and resilience of individual banks from a micro-perspective. From a macro, or systemic point of view, such a finding would not necessarily be desirable and could even be potentially worrying. It might imply that a future economic or financial crisis would negatively affect all types of banks at the same time in a similar way and to the same extent. The convergence of key metrics could in that case signal a deterioration of systemic stability in banking.

Higher efficiency levels

The average cost-income ratios fell in 2017. The CI-ratio of co-operative banks decreased by 1 percentage point to 64. All other banks experienced a drop in this indicator of around 2 percentage points to 61. It is not easy to pinpoint the causes for the higher efficiency levels, since this ratio is influenced by many factors. However, one can conclude that co-operative banks have always operated with slightly higher cost-income ratios. The relatively dense branch networks of co-operative banks do not translate into a substantially higher CI-ratio.

Figure 5 Cost-income ratio of co-operative banking groups and the entire banking sector



Source: Own calculations based on data from co-operative banking groups, national supervisory authorities, the ECB and Swiss National Bank.