OLIVER WYMAN

Financial Services

Co-operative Bank: Customer Champion

MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Foreword

We would like to thank Oliver Wyman for the interest taken in the European co-operative banking sector. This report contributes to a better understanding of the co-operative banks' business model which is a real asset for citizens and SMEs in Europe. Co-operative banking represents a significant, and in some countries, majority part of the banking industry. As such it is critical to consumers and businesses. With the recent shift in market conditions and the return of volatility, we believe that the co-operative model – as a distinct way to run a bank – creates a pluralist and more stable system, and is more vital than ever. Even though the conditions which led to the formation of co-operative banks in the 19th century have changed, our banks still remain, at the beginning of the 21st century, front-runners. We welcome this timely analysis that visits the past by looking at the future opportunities and possible evolutions for our sector.

Dr Christopher Pleister
EACB President

Hervé Guider
EACB General Manager

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Summary

Co-operative banks represent a major force in European banking. With over 140 million customers, co-operative banks have a relationship with one in 5 European citizens. Across Europe there are 4,500 co-operative banks with 60,000 branches and a combined 20% market share. In five European countries, co-operative banks account for over 40% of all retail branches. The co-operative sector is also a major employer, with more than 720,000 staff.

The co-operative movement had its origins in the 19th century, as a way to allow lenders to protect themselves from the credit risk of customers for whom credit information was not available, and in particular the rural poor. In the century that has passed, this information advantage has shifted from the customer to the bank. The rich information provided to banks by credit bureaux and by their own systems has allowed for a rapid expansion of banking services to almost all sections of the community. At the same time, the growth of a broader, more complex set of financial products means that retail financial services now contain an asymmetry in favour of the bank. This is widely accepted and explains the amount of regulation surrounding the retail financial services industry. It also explains why many banks, whether co-operative or commercial, have adopted a customer advocacy proposition as a way to allay concerns over potential abuse.

The co-operative model is to some extent self-regulating in that the owners are customers and therefore less able or willing to exploit their asymmetric advantage. As such, we see the co-operative model as a natural platform for customer advocacy, and see a powerful proposition for the movement as customer champions, and as an alternative to the commercial banking model.

The flip-side is that the co-operative model creates several management challenges, relative to the shareholder-owned commercial model. The most obvious and studied of these is the agency problem, in which the motivation for managers to act on behalf of owners is less obvious in a co-operative structure than a shareholder owned one. Co-operative banks have acted to mitigate this, for example, through the use of local customer boards, and there is good evidence for a marked improvement in operating efficiency in the sector. At the same time, we note the current role of activist shareholders in commercial banks which suggests that the agency problem is not unique to the co-operative model.

To ensure that co-operatives deliver against a promise of being customer champions, we see a five point action plan for them individually and as a sector. The mantra linking these actions is "commercial delivery of co-operative values":

- **Execution** – ensure you at least match industry norms on growth and efficiency. High growth is the ultimate signal that the customer champion proposition is being delivered, high efficiency signals that the agency problem has been dealt with. As a general observation, co-operatives do well on both measures, but with a significant dispersion amongst individual banks. Under-performers damage not only their own reputation, but that of the co-operative model as a whole, and so have a duty to improve their performance.
- **Membership** – expand beyond self-imposed boundaries to offer membership widely and to all vulnerable customer groups. Membership policy can be restrictive. This can make it a low and ageing percentage of the customer base. Membership is the core concept underpinning the claim to being the customer champion and should be promoted to the fullest extent possible, with a particular focus on vulnerable customer groups.
- **Capitalisation** – ensure discipline in managing the capital base. The co-operative model was designed to accumulate capital and has done so, with co-operative banks typically holding around 1 to 4% more tier 1 capital than commercial banks. In the current volatile market conditions, this capital buffer may seem attractive, but in the long-run it is unproductive for the economy and reduces discipline on the bank to deploy its capital efficiently. There is an inherent conflict between member growth advocated above and capital efficiency which will require co-operatives to think creatively about member definition and capital release.
- **Governance** – define common approaches that reinforce the co-operative model. The co-operative model is distinct from the commercial model, and diverse in how it is manifested in different co-operative banks. As such, regulators will have an understandable concern about the effectiveness of the governance model. Many co-operatives have adopted specific mechanisms to ensure good governance, and there is an opportunity for the best of these mechanisms to be distilled into a target governance model that the sector as a whole adopts.

- **Expansion** – create a method for exporting the co-operative model to new markets and banks. Most of the world's banking is done through the commercial model. Where co-operatives have expanded, they have typically done so by acquiring and sustaining a commercial model. This raises two challenges. First, finding a way to seed the co-operative model into new countries. Secondly, finding a way to expand as a co-operative through acquisition that brings co-operative values in full to the customers acquired.

In summary, the customer champion proposition is natural to the co-operative bank model, and is needed more than ever. Many commercial banks also recognise the power of a customer advocacy position and will fight hard to own this position. Co-operative banks have been built on the accumulated capital of past members and so have a duty to use it to deliver that proposition to as wide a membership base as possible. The two key indicators of whether co-operatives are acting as customer champions are their growth and efficiency. The former shows that a wider, deeper membership is being created on the back of customer appeal. The second shows that the agency problem has been overcome and that co-operatives are acting in the full interests of their members. Many co-operatives are delivering strongly on both measures. Those that are not need to raise their performance so that they do not undermine the reputation of the co-operative model as a whole.

As a final observation, much of the analysis and debate around the co-operative model implies a choice between it versus the commercial model. Outside of the anglosphere where demutualisation has occurred, this is not a choice that is likely to be made. With a high level of regulatory scrutiny of retail financial services across Europe, and a return of market volatility, the plurality offered by the co-operative model should be seen as valuable to regulators and customers alike.

Introduction

Context

Co-operative banks have developed from humble origins to become significant players in the European financial services industry. Recognisable as national champions in their own markets, as a sector these organisations comprise a diverse set of financial services institutions, ranging from domestic retail focussed players to large multi national universal banks. Today almost one in five European citizens transact with a co-operative bank, through a network of 4,500 banks and 60,000 branches.

The co-operative model was originally focussed on combating financial exclusion in industrialising economies, and in particular for the rural poor where commercial banks lacked the information to allow them to lend safely. The co-operative model carries unique features that are inherent to its member ownership and that lead to benefits and challenges that are neither widely recognised nor understood.

Purpose of the report

The four objectives of this report are to:

1. Provide an overview of the current state of co-operative banking in Europe
2. Offer insights into the issues faced by co-operative banks
3. Discuss the purpose of co-operative banks and how they deliver on this
4. Describe the future challenges facing co-operative banks

Oliver Wyman has created this report on a *pro bono* basis. We work with commercial and co-operative banks alike, and view ourselves as objective analysts of the co-operative sector. A preponderance of academic and commercial literature seeks to understand which of the co-operative or commercial banks represents the “winning” model. Here, we take a pragmatic view, noting that in most European countries, the models co-exist and that neither shows much inclination to convert to the other model. Our approach is therefore to take the co-operative model as a given, and to focus on its inherent features as a basis for defining a core purpose and future agenda for these banks.

Approach

This report focuses on the co-operative banks as represented by the European Association of Co-operative Banks (EACB), examining the following nine core geographies as representative of Europe as a whole:

Austria	Germany	Spain
Finland	Italy	Switzerland
France	Netherlands	United Kingdom

A broad coverage has been achieved with this country selection – according to EACB estimates, the players found in these countries accounted for over 98% of the assets held by the co-operative banking sector in 2006.

In writing this report, we have attempted to draw on the widest possible range of information, including published reports, academic research and our own primary research. This primary research consisted of a detailed questionnaire and supporting data request sent out to the co-operative banks from the nine core geographies, alongside interviews with over 20 participants from the industry, including national associations, executive management and policy makers.

Data is an important constraint on the depth of analysis that can be undertaken. We have, therefore, supplemented quantitative data on markets and bank performance with qualitative information obtained from interviews and market experience.

Format of the report

This report starts with an introduction to the co-operative banking sector in Europe, its origins, evolution and current status. Further chapters explore the current concerns found within the sector, suggest a core purpose that can unite co-operative banks despite their diversity, and detail the challenges that they will face in the years to come.

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Context: history and evolution of the sector

Co-operative banks have a long and diverse history

The history of many co-operative banks can be traced to the financial exclusion faced by many sections of the population in 19th century Europe. With the industrial revolution in full swing, the emerging financial services sector was primarily focused on wealthy individuals and large enterprises found in urban areas. The rural population in particular, farmers, small businesses and the communities they supported, were effectively excluded from financial services.

Four main factors contributed to this exclusion:

- Physical location – With transport and communication infrastructure still nascent, and the provision of financial services concentrated in urban areas, accessibility was a significant issue for those in rural areas
- Information asymmetry – Banks were reluctant to provide credit to certain groups as they did not possess sufficient information on their activities to estimate the risk involved
- Legal system – Managing customers' contractual obligations was not only costly but also technically difficult for the banks – the ability to repossess any collateral that was offered against a loan was also significantly limited
- High prices – Where credit was made available via usurers, the interest rate was often punitive

Co-operative banks proved the ideal solution to correct this market failure. Founded in local areas for the immediate community and owned by that same community, and operating under the principles of solidarity and democracy, these institutions were specifically created to fill the vacuum and provide financial services to the otherwise unbanked population.

Despite addressing similar issues, distinct co-operative banking models emerged across Europe, whether in terms of founding ideology (such as the Raiffeisen and Schulze-Delitzsch movements) or their organisational structures (top-down versus bottom-up). The origins of these different models can still be recognised today, and in some instances accounts for some important differences across the sector. For example, many co-operative banks still carry the Raiffeisen name, in homage to the pioneer who promoted the benefits of the co-operative banking model amongst rural communities, whilst The Co-operative Bank in the UK operates a distinctly top-down organisation model in comparison to other co-operative banks, following from its origins as the banking division of a co-operative wholesale society.

The resulting diversity of co-operative banks that exists today carries two distinct implications: on the one hand providing a stimulating and varied subject matter for commentators, whilst on the other making it very difficult to draw universal observations and recommendations that apply to the whole sector. This report nevertheless attempts to derive conclusions that apply to the majority of co-operative banks, recognising that in some instances the differences between individual players prohibit addressing the sector as a whole.

Co-operative banks have evolved over time

In common with any organisation boasting a long history, co-operative banks have undergone considerable evolution from their original foundations to the institutions that they have become today. This evolution can be characterised into several themes, whilst recognising the rich diversity across the co-operative banking sector: some co-operatives have experienced these steps to a lesser extent, or in a different order.

Case study: Rabobank

1864: Friedrich Wilhelm Raiffeisen founded the first agricultural co-operative bank in Germany.

1890s: Followers of the Raiffeisen movement start co-operative banks serving Dutch farmers.

1898: Foundation of two central co-operative banks, the Coöperatieve Centrale Raiffeisen-Bank in Utrecht covering 6 local banks in the north, and the Coöperatieve Centrale Boerenleenbank in Eindhoven covering 22 local banks in the south.

1920s: Co-operative banks become the market leader for deposits.

1940s: The number of local co-operative banks has rapidly grown to 1,300 and stabilises at this magnitude.

1960s: Mergers between local banks begin commences.

1970: Partnership between the two central banks.

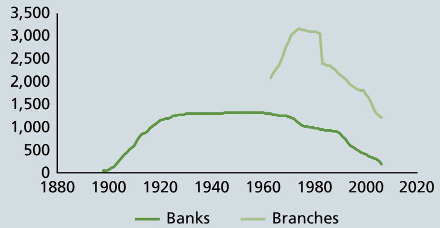
1972: The central banks merge, to form Coöperatieve Centrale Raiffeisen-Boerenleenbank – known as Rabobank.

1970s-1980s: Cross-border activities increase, initially to support business customers engaged in international trade.

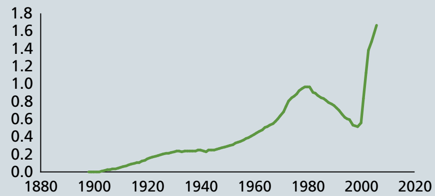
1990s: Changes to regulation allow banks and insurance companies to operate under the same organisational structure supporting further diversification of financial activities. Membership proposition is reviewed, whilst the number of local banks continues to decline.

2000s: Further international expansion through purchases in Ireland and the USA. Strategies to recruit and involve more members result in a sharp increase in their number.

Local Rabobanks and branches 1898-2006



Rabobanks members (in millions) 1903-2006



Source: Rabobank History Department

Expansion

Following their conception during the 19th century, strong demand and popularity of the model led to explosive growth in co-operative banks. This was most pronounced in Austria: following the organisation of the first Schulze-Delitzch and Raiffeisen societies in 1858 and 1866 respectively the number increased to 3,600 and 8,000 societies respectively in the 50 years leading up to the start of the First World War.

Centralisation

In harmony with co-operative principles, individual banks began to co-operate with each other and share resources, leading to the creation of regional and central banks to support the collective needs of the network. Local banks began to offer a more homogenised service, and to act under common brands.

Consolidation

As mobility of labour and capital increased during the 20th century, competition within retail banking intensified. This led to different forms of consolidation to achieve efficiency gains:

- Consolidation at a local level – particularly through the merger (and in some instances closure) of branches and local banks as witnessed in Finland, The Netherlands and Germany
- Consolidation at a regional level in those countries where a three tier system operates – predominantly in France
- Consolidation at a central level between co-operatives – as per the merger of the central co-operatives of Raiffeisen-Bank and Boerenleenbank to form Rabobank Nederland, and the association of the Volksbanken and Raiffeisen banks and their supporting infrastructure to form the FinanzVerbund in Germany
- Consolidation at a central level with non co-operative banks (referred to in this report as "commercial" banks) – as per the absorption of Cera into KBC in Belgium

Diversification

In common with commercial banks, co-operative banks have diversified away from purely retail and small business banking into commercial and corporate banking, and increasingly access capital markets for funding rather than depend solely on their members for capital. Some co-operative banks have expanded the scope of their operations beyond their domestic market, with significant international operations. For example, Crédit Agricole SA of France operates in over 60 countries across the globe, whilst Raiffeisen

International (a subsidiary of Vienna-based Raiffeisen Zentralbank Österreich AG) is present in 18 different countries throughout Central and Eastern Europe.

Within retail and small business banking, co-operative banks have widened the range of products and services they can offer over time, in line with non co-operative competition. This was supported by the results of the survey of co-operative banks which showed a full banking product and service coverage.

Co-operative banks today

Co-operative banks have grown from humble origins to become significant players, and increasingly resemble diversified organisations with operations across financial services and spanning multiple geographies – few resemble the simple saving and loans institutions they once were (Figure 1).

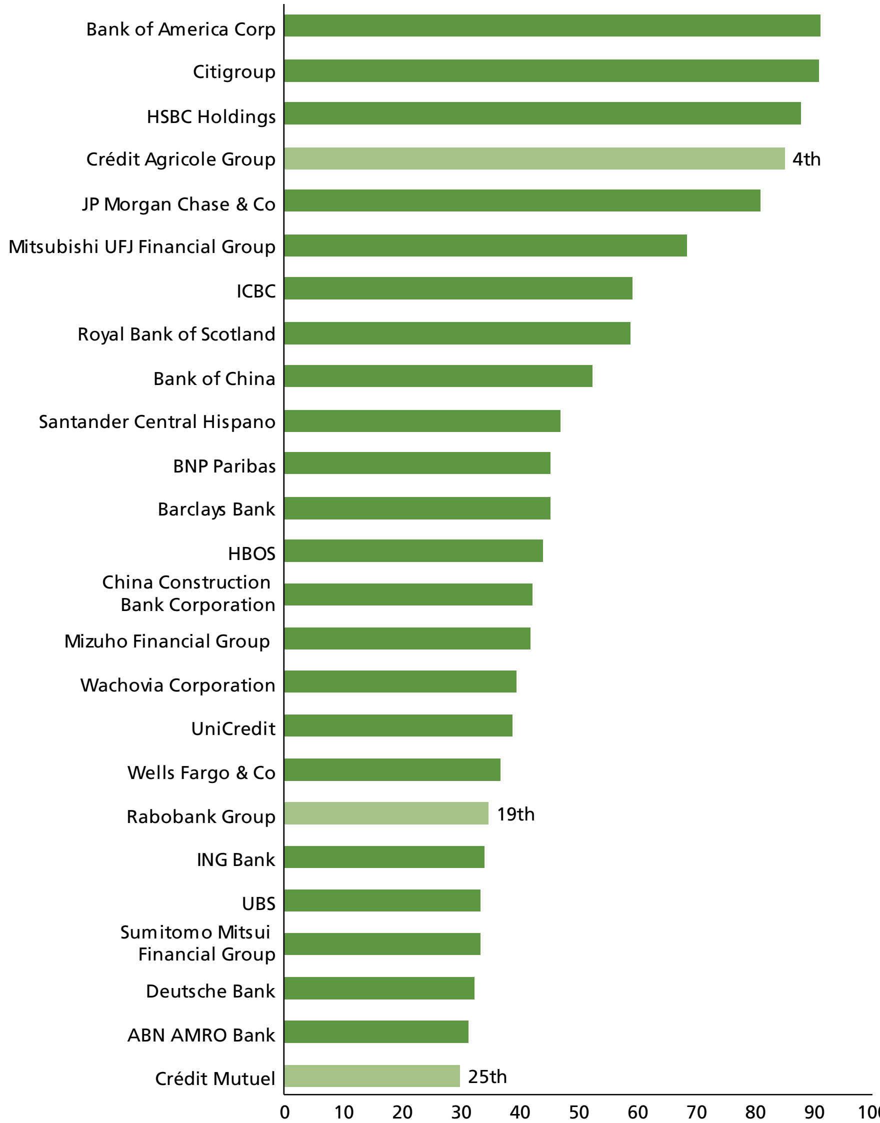
Figure 1: Table of major European co-operative banking groups by country including market share of deposits and credits (2006)

Country	Collective name	Deposits	Credits
Austria	Raiffeisen	27.8%	23.4%
	Volksbanken	7.1%	7.7%
Finland	OP-Pojhola Group	32.7%	31.1%
France	Crédit Agricole	25.0%	20.9%
	Crédit Mutuel	12.4%	16.8%
	Banques Populaires	6.2%	8.2%
Germany	FinanzVerbund	15.8%	11.8%
Italy	Banche Popolari	21.9%	20.1%
	Banche di Credito Cooperativo	8.4%	6.6%
Netherlands	Rabobank Nederland	39.0%	25.5%
Spain	Cajas Rurales, Populares y Profesionales	5.0%	5.2%
Switzerland	Raiffeisen	18.6%	12.1%
UK	The Co-operative Bank	1.0%	0.7%

Source: Key statistics 2006, European Association of Co-operative Banks

At a country level, co-operative banks are often identified as national champions with sizeable branch networks and considerable retail market share. They comprise some of the largest financial services institutions in Europe, together serving in excess of 140 million customers across the continent. Nor are they purely a European phenomenon: measured on banking capital, three co-operatives rank in the top 25 institutions in the world (Figure 2).

Figure 2: Top 25 banking groups by Tier one capital in 2006



Source: The Banker (2007)

However, the origins of co-operative banks and their different evolutionary paths cannot be underestimated. Co-operative banking groups vary across member states, in terms of the overall business model they operate, their attitudes to membership and their interpretation of co-operative values.

Figure 3 serves as an illustration of this. On some dimensions co-operative banks have remained true to the traditional models and approaches found at their inception, whilst for others there has been a significant departure.

Figure 3: Many flavours of co-operative banking

	From the traditional…	…to the non-traditional
Overall business model		
Business mix	■ Some banks still derive over 95% of their income from domestic retail business	■ Others derive over a third of their income from non-traditional (i.e. non-retail) business
Geographical coverage	■ Some banks operate only in their domestic market	■ Others earn a quarter of their income abroad
Share listing	■ Some banks are strongly opposed to moving towards a share ownership model	■ Others exhibit a hybrid model, listing parts of their organisation
Attitudes to membership		
Membership strategy	■ Some banks strive to make every customer a member	■ Others are not actively recruiting members
Profit redistribution	■ Some banks pay a standard dividend	■ Others distribute profits based through loyalty schemes or promotional products and services
Capital contribution	■ Some banks place a lot of emphasis on ownership rights and responsibilities	■ Others do not require members to hold a share in the business
Adherence to co-operative values		
Local bank autonomy	■ Some primary banks have the discretion to take their own decisions regarding pricing, risk-taking etc.	■ Others have to follow central guidelines on most matters
Investment in local communities	■ Some banks do not have a good overview of their activities, are not very strategic about the costs and benefits etc.	■ Others are highly transparent about their sponsoring, publish a report on annual spending and activities etc.
Education and training	■ Some banks spend above-average amounts on staff training etc. and emphasise their co-operative nature in all communication	■ Others are not distinguishable from commercial banks in this area

Current concerns

Whilst the co-operative banking sector is a significant component of today's financial services landscape in Europe, it rests on a distinctive organisational model that sits apart from the shareholder-owned commercial structure typical of most other banks and enterprises. As such, co-operative banks are frequently required to justify their unique positioning whether because of concerns about member ownership as a barrier to merger and acquisition, because of agency problems or simply because of the added supervisory complexity of having plural models. Whilst the priority and relevance of these challenges varies over time and by stakeholder, the most important of these are explored in this chapter.

Original raison d'etre is disappearing

Co-operative banks were originally created to correct the market failure of restricted access to banking services for large proportions of the population, primarily due to physical location and information asymmetry. However these sources of market failure have decreased significantly in most European countries in the last 50 years. Access is no longer the major issue it once was, as innovation in transport and communication has put banking services within easy reach, whilst technology and experience have helped to reduce the information gaps previously faced by banks in assessing potential customers. This increased transparency has further placed downward pressure on margins and prices. Further, in many countries positive and negative credit bureaux allow banks to make informed credit decisions that have resulted in substantial commercial lending to near and sub-prime customers. Whatever the commercial merit of these decisions, it is hard to argue that financial exclusion is a major feature of developed financial markets.

Boundaries between co-operatives and their competitors are blurring

From an external perspective, co-operative banks increasingly resemble commercial banks, whether through choice or necessity. This is due to a number of factors:

Reduced local autonomy: Previously co-operative banks could be characterised as a loose affiliation of independents with significant autonomy and discretion for local banks in managing their affairs. However several developments have challenged this approach, not least the increased requirement for centralised business functions to deliver efficiency gains through economies of scale. Some institutions have also gained agility from some centralised decision making versus a more traditional, consensus driven approach.

Decreased reliance on customers for capital: The majority of co-operative banks were founded on the capital contributions received from their members – in return for this contribution, members received a vote and therefore a say in how the co-operative was managed. However the dependence on the members for funding has reduced, whilst the list of stakeholders to appease has increased. Most co-operative banks now access the debt capital markets and therefore must satisfy ratings agency requirements to secure funding on favourable terms. Further some co-operative banks have listed parts of their business, weakening the original, purely democratic principle of one member one vote, requiring management to act increasingly in favour of shareholders rather than members.

Increased organisational complexity: Co-operative banks today increasingly consist of complex ownership structures that mimic the organisational models of commercial banks. Aside from issues regarding the balancing of joint shareholder and member ownership, the use of subsidiaries to control diversified business functions (such as Corporate and Investment Banking and international activities) puts further distance between member owners and income generating activity. The transparency of the subsidiaries' performance and their contribution to the co-operative bank can be difficult to trace and the benefits to members are less apparent.

The differences that remain are prone to attack

The legacy differences that remain between co-operative and commercial banks are often poorly understood, and can act as a source of unwarranted or ill-conceived criticism.

One member one vote: Because co-operative banks are typically owned by their members, a "one member, one vote" principle applies. This has two significant implications.

Firstly, unique governance mechanisms are required for members to exercise their democratic right in an effective manner, typically consisting of several tiers that cascade up from general assemblies and boards of directors at a local level through to regional and central decision making bodies that influence executive management. This can lead to concerns that decision making is slow with a corresponding loss of agility for the organisation. In economic terms, it raises a possible *agency* problem, of whether managers will serve owners best interests, where that owner is a customer-member rather than a shareholder. It is worth noting that the current wave of shareholder activism suggests at least some degree of an agency problem within the commercial model. The argument for member ownership is that it leads to a consensus-driven approach and hence more thorough, albeit conservative decisions suited to a long-term time horizon.

Secondly, the "one member, one vote" model has drawn criticism at an international level for acting as a barrier to consolidation in the financial services industry. This ownership structure makes it effectively impossible for a co-operative bank to be subject to a hostile takeover. However, mergers on a mutually agreed basis are feasible, whilst co-operatives themselves are capable of acquiring non co-operative competitors provided they can raise the required capital, and have done so in the past. By contrast, at a national level, the "one member, one vote" ownership structure is often praised for nurturing national champions – strong local players, that are aligned to customers needs and promote stability via high capital positions.

Capital reserves and returns: On average, co-operative banks hold higher amounts of capital and returns on this capital are often lower than industry averages. This leads to criticisms that co-operatives horde capital that could be used elsewhere in the economy, and that co-operatives hold an unfair advantage over their competitors as they need achieve lower levels of profitability to remain a going concern.

This difference in performance can be explained due to the distinct ownership structure employed by co-operatives compared with stock-holder companies. Co-operative banks accumulate capital by design, as their original purpose was to overcome a shortage of capital for their chosen activities. Further, the opportunities to manage capital in and out are often limited for a co-operative, which may be forced to operate under statutes and regulations that dictate how capital is managed. Ownership of capital is also unclear: past, present and future members all have a claim. Finally, co-operative banks are reliant upon internal capital for strategic investments, whilst the commercial banks have greater access to raise additional funds, for example through the issuance of stock.

Similarly, the demands on capital are less acute. Members of co-operative banks typically take a longer term, risk-adverse view than shareholder-owned banks, with a correspondingly lower expected return. Moreover, financial rewards are not the primary reason for customers, and in some instances employees, to be owners via membership – the provision of good value products and services is assumed to take precedence over profits as a motivating factor.

Large retail branch networks: Following from their origins in rural areas, many co-operative banking networks enjoy a significant market share in their domestic business and are often the largest player in terms of number of branches or office locations in their domestic market. One criticism of co-operative banks is that they garner an unfair advantage from their legacy networks: as the "only branch in town" in some cases, co-operatives enjoy a near monopoly position in local markets that are too costly for competitors to enter.

Counter arguments to this acknowledge the fact that number of physical locations is of declining importance in mature economies, as transport and communication developments improve accessibility to banking products and services. This can be recognised by the closing of branches in some countries over the last decade. Additionally the high fixed costs of operating branches, particularly in rural areas where the population served per branch is substantially below average, do not always make such networks economically favourable.

Finally, there is nothing to prevent commercial entrants opening up branches if super-normal profits are obtainable there. The last decade has seen a resurgence in branch building in certain markets, where new formats and technology have led to a big reduction in the fixed cost investment to establish a branch. Some co-operative banks have also responded to this by further expanding their footprint - e.g. Crédit Mutuel in France has expanded its branch network every year since 2002.

Cohesion within the sector: Towards a new core purpose

Without a single, common purpose for co-operative banks to unite behind, the sector will continue to be on the defensive. With their original purpose having largely disappeared, and with a variety of co-operative models, some of which come close to that of the commercial alternative, co-operative banks need to define their future purpose. This core purpose must be addressed to three key audiences:

- The co-operative banks themselves as a means to set their strategy and direct their agenda towards delivery of the core purpose
- Current and potential members as a way to signal the value of choosing a co-operative bank over a commercial alternative
- Regulators as a means to improve understanding of the co-operative model and why the inevitable complexity of supervising a pluralist system is justified by the distinct benefits brought by the co-operatives

Without a clear, compelling and unifying answer to the question "Why do we exist?" co-operative banks are in danger of undermining their existence. Divergence in strategy and approaches to these problems across co-operative banks will weaken their power as a group and the representation they can command in response to threats from regulatory and legislative changes. In addition, convergence with commercial players will further reduce the proposition that they can offer their members which could cause declining markets shares, and, in extreme circumstances, could result in the closure of their business or the loss of their co-operative status, as witnessed in the conversion of many of the Building Societies in the UK into shareholder institutions.

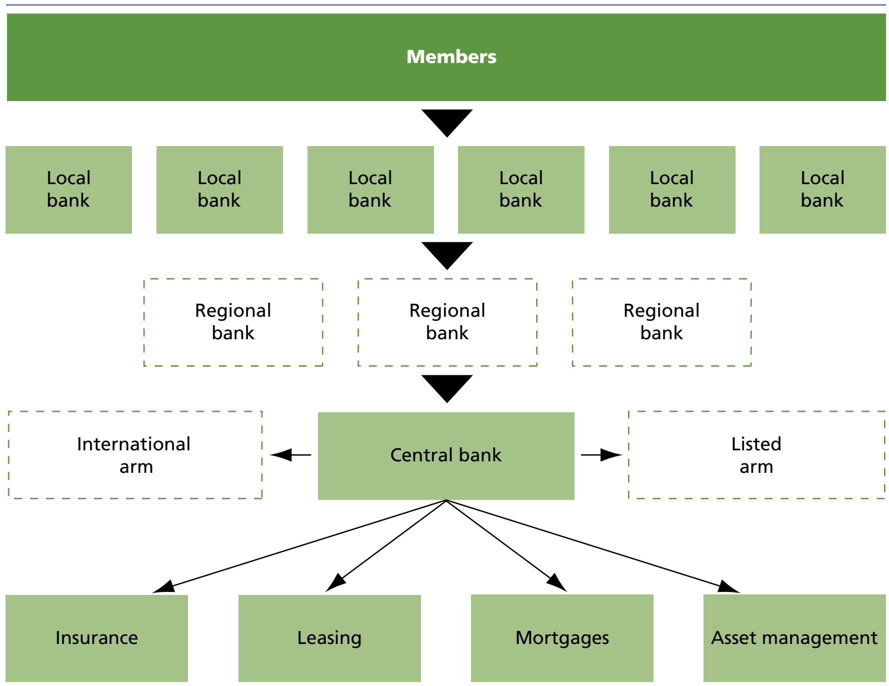
Core purpose: Customer champions

Previous sections have made references to the diverse nature of co-operative banks and the challenges they face. However this diversity is balanced by some key attributes that co-operative banks share. Leveraged effectively, either individually or as a group, co-operative banks can use these attributes to their members' advantage and safeguard their future. The following section puts forward the case for co-operative banks to unite behind a single core purpose of becoming customer champions in the financial services industry.

Member ownership

Significant diversity exists across the co-operative banking sector in Europe. This is particularly apparent when examining the organisational structure of the different co-operative banking networks. The stylised structure below represents a three-tier network, comprising local, regional and central organisations.

Figure 4: Stylised organisational structure for a co-operative bank



In reality, the adherence to this stylised model varies. Some banking networks have no central or regional tiers in their organisation. Others use the different strata to support different activities. In some organisations, for example, the regional associations provide consulting advice and audit capabilities, whilst in others, the regional bodies take a full central banking role, provide product and marketing support, liquidity and risk management as well as IT capabilities.

Despite the significant differences in the organisation, all networks share one common and defining feature – *member ownership*. The local banks are effectively owned and controlled by their local customers through the membership concept. The local banks in turn own and control the supporting infrastructure, regardless of the number of tiers, their roles and the authority that has been delegated to them.

The member ownership concept in not only central to the co-operative ideology but is also a unique aspect that is hard to replicate outside of co-operative structures. Vital to the establishment of co-operative banks, it remains today their common and defining feature as well as a source of differentiation versus non co-operative competition.

Tackling information asymmetry

Member ownership is the defining characteristic of co-operative banks, regardless of the many differences in their organisational set-up. Member ownership was a fundamental design choice for creating co-operatives in the first place, and should remain so today.

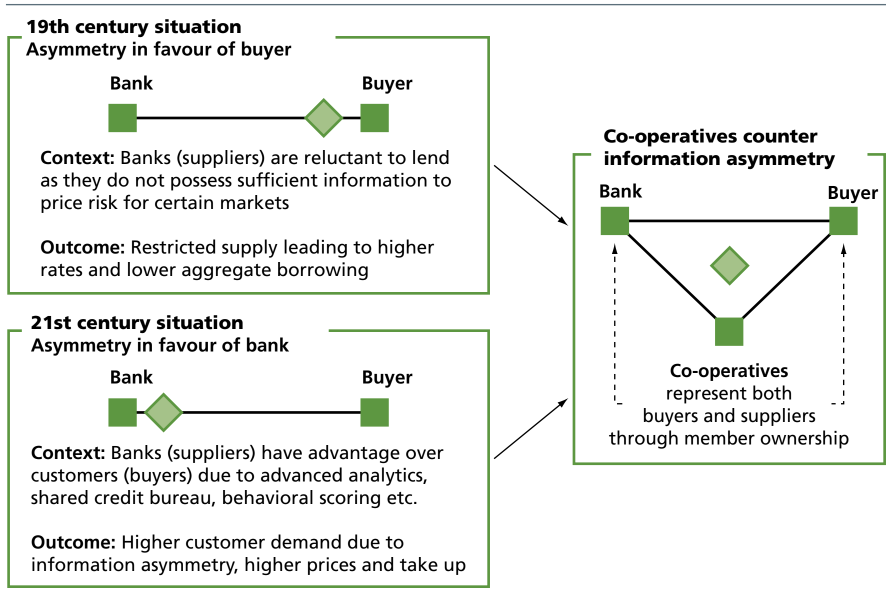
Originally, member ownership was conceived as a device to address the challenges of information asymmetry that favoured the recipients of banking services. Specifically, banks could not be sure of the credit-worthiness of borrowers, and member ownership was a way to protect against poor credit information. This feature has renewed relevance in today's financial services industry but for the reverse reason, in that the information bias has shifted in favour of the suppliers of banking services, exposing customers to poor choices of provider and product.

Consider the market for credit in the 19th century compared to the market today. In the first case, before co-operatives were introduced, banks (i.e. suppliers) were reluctant to lend as they did not possess sufficient information to price risk for certain markets. This was particularly true for banks based in urban areas that had little appreciation of agricultural matters. The information advantage was held by customers (i.e. buyers) who had a much better understanding of their own situation – what they were prepared to pay or how likely they were to default. This information asymmetry restricted the supply of credit, leading to higher rates and lower aggregate borrowing than would have been optimal if the information asymmetry were reduced.

In today's market, banks have the information advantage given the availability of large data sets on past customer performance, advanced analytics on propensity and credit risk, shared credit bureau data, and behavioural scoring. Equally, the amount of choices facing buyers have grown. In a market which for many customers is a "low-involvement" decision, this leads to an asymmetric advantage in favour of the bank. The consequences of this have been a growing layer of regulation designed to protect customers from over-charging and mis-selling.

In either case, co-operatives tackle information asymmetry via membership (in some markets, particularly small businesses, it can be argued that the lack of adequate information to estimate risk still prevails today). If the customers of the organisation are also the owners, the motivation to use information asymmetry to the detriment of the other party in a transaction is reduced.

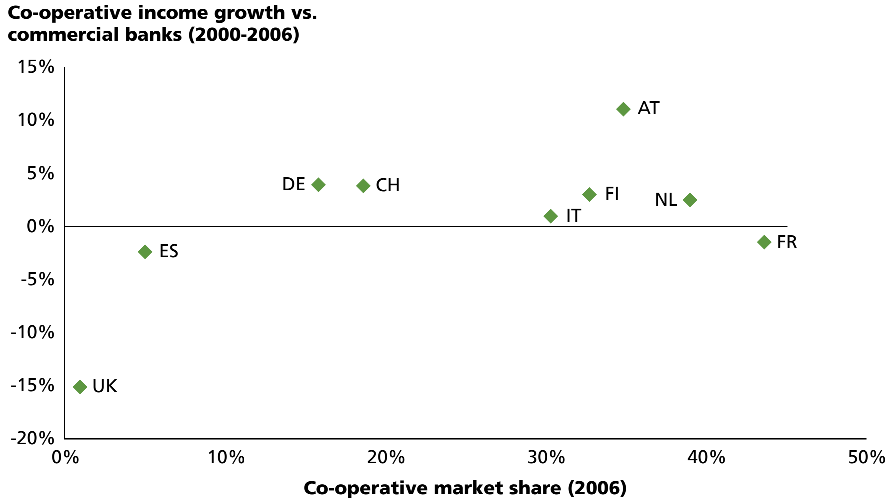
Figure 5: Co-operative banks tackle information asymmetry



Co-operative dividend

The popularity of the co-operative banking model is evident in their continued high market share and growth rates relative to their commercial competitors.

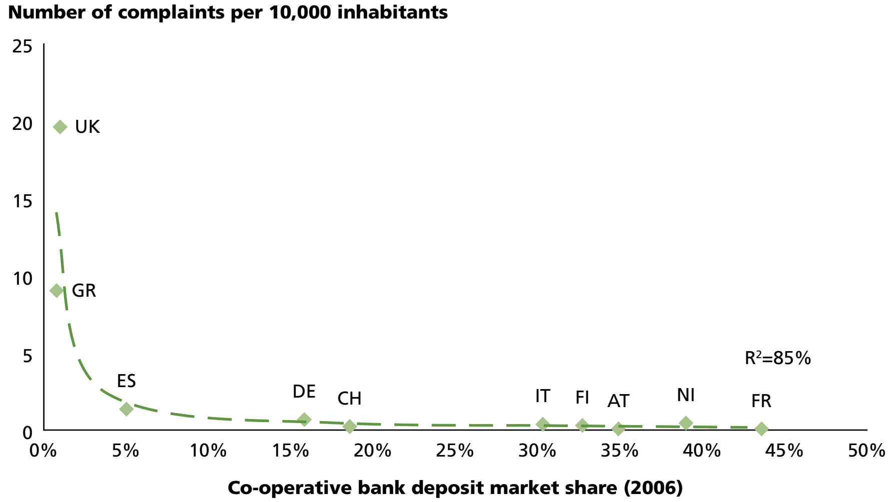
Figure 6: Co-operative bank market share and relative group income growth by country



Source: Oliver Wyman analysis

The level of customer satisfaction with co-operative banks is also supported by survey and anecdotal evidence from customers. As an indicator of this, complaint levels across Europe provide an interesting, if loose, comparison with the number of complaints to the ombudsman in a given country showing an inverse relationship to the market share of co-operative banks. There may of course be many other factors at play that could explain this picture, such as customer expectations in a given market (for example, in a more competitive commercial market, customers may feel it is more worthwhile complaining). Nevertheless, the popularity of the co-operative model coupled with the amount of regulatory friction in largely commercial banking countries suggests that the co-operative model is a valuable additional model to have present.

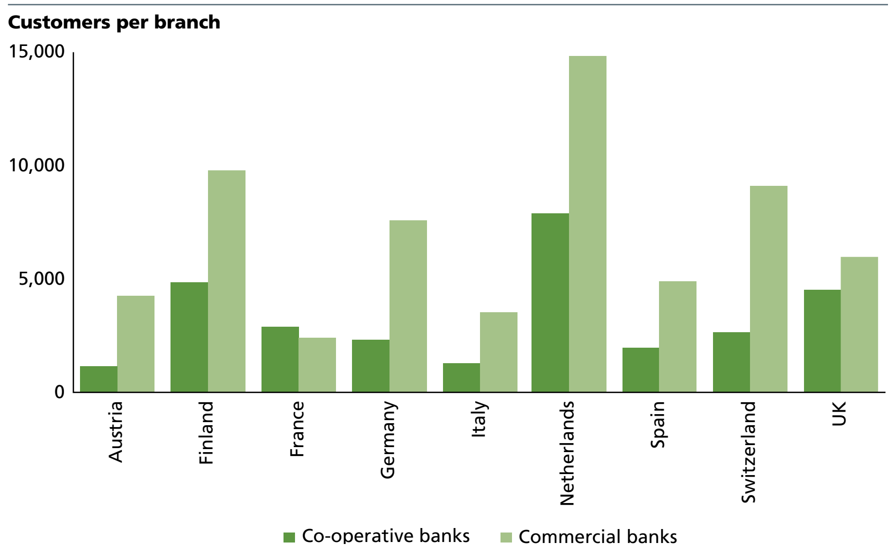
Figure 7: Number of complaints to financial services ombudsmen vs. market share of co-operative banks



Source: Country ombudsmen reports, Oliver Wyman analysis

The underlying reasons for higher satisfaction may be hard to isolate. However the proximity that co-operative banks have to their customers and the strength of relationships that this allows are likely contributing factors. Co-operative banks typically have a higher branch density than their competitors and serve fewer customers per branch. While this could be considered a source of inefficiency, it is largely a reflection of the small, fragmented rural communities they serve. Most importantly, it allows co-operative banks to be more accessible to their customers through their branch network, and to spend more time in person with their customers.

Figure 8: Number of customers per branch



Source: EFMA World Banking Report (2007), company websites and annual reports

To reinforce this proximity to their customers, co-operative banks are also active supporters of the local communities that they serve. Through a range of local, regional and occasionally national initiatives, co-operative banks position themselves as supporters of causes that resonate with their customer base[1]. Indeed, many argue that through their presence and day-to-day operations in the community, co-operatives are an important driver of local employment, whether directly by working for the bank or for the small and medium enterprises that they help finance. This "co-operative dividend" that is given back to the community helps build customer loyalty and trust, and serves as an important differentiator against the non co-operative competition. We note that many commercial banks are trying to re-create some of this proximity within large, national networks through concepts such as local market management and empowerment.

Core purpose

Co-operatives should unite behind a core purpose to act as customer champions, building from the platform of member ownership. This unique and defining feature of co-operatives should be placed at the centre of their strategic thinking and operational delivery, and should be fully utilised to address information asymmetry in financial services. By acting in this manner, co-operatives not only reinforce the benefits of their distinct model to their own customers, but also bring further discipline to the financial sector as a whole – competitors will be hard placed to treat their own customers unfairly if co-operatives determinedly place their customers' interests first.

A confluence of factors makes it timely for co-operatives to promote their role within financial services. Firstly, a general distrust of the sector has emerged recently, particularly driven by media accusations of corporate greed in light of the sustained and often record profits that have been earned by bank shareholders over the last decade. Secondly, the market for financial products has become more complex and in recent times more volatile, raising informational asymmetry in favour of suppliers with which buyers must contend.

Co-operatives offer an alternative destination for bank profits that hold an intrinsic appeal: the bank's own customers. Similarly, by taking a more customer-centric approach to the provision of banking services, co-operatives can provide an attractive proposition within the market place, and can capitalise on the backlash against commoditised offerings and a "product push" approach.

1 For more information please see the 2007 EACB report "Co-operative Banks: Catalysts for economic and social cohesion in Europe"

The rise of a more "compassionate consumerism" across Europe also fits neatly with the co-operative ethos. As issues such as the environment and the role of charities gain further prominence, co-operatives have a strong opportunity to establish themselves as ethical organisations that are in touch with the concerns of their customers. This approach has been taken to the extreme by the likes of The Co-operative Bank in the UK which has positioned itself as an ethical bank.

The current economic climate also favours the more conservative approach taken by co-operatives. With the recent turmoil in credit markets and resulting liquidity issues, co-operatives are ideally placed to offer a secure home for savings and investment. Working to more risk-averse, longer time horizon investment objectives than shareholder driven institutions, co-operatives currently represent a relatively safe haven for investors and perform a stabilising influence in the financial services market, as recognised by rating agencies and others[2]. In combination with their conservative attitudes, their member-driven governance procedures offer an ideal formula to satisfy the growing attitude for owner activism and to quell fears that customers have little control over their own money, including how it is used and its relative safety.

Communication

The case for co-operatives acting as customer champions within the financial sector has been presented above. Regardless, a well executed public relations campaign is required to mobilise opinion and make co-operative banking a widely accepted good. This should target not only their potential customers, but also regulators and commentators. It should clearly explain the benefits that co-operatives bring to the individuals whom they serve, as well as to society as a whole. This would also be the ideal opportunity to correct misconceptions and common misunderstandings that may be held in different markets.

2 See the 2007 IMF Working Paper "Cooperative Banks and Financial Stability"

Future challenges

Like other banks, co-operatives face a rapidly moving sector in which technology, cross-border mergers, regulation, credit booms and bust are just some of the factors at play. However, co-operative banks also face a distinct set of challenges that arise from their member ownership and which they need to address if they are to live up to the proposed core purpose of customer champions. The scale of these challenges varies from institution to institution, and whilst some will therefore fall to management to address on an individual basis, others will benefit from coordinated, sector-wide initiatives.

Execution

The first challenge is to establish a suitable framework to measure and manage the performance of co-operatives in behaving as true customer champions. The difficulty arises from acknowledging that financial measures used to measure bank performance typically focus on the returns to shareholders. For co-operatives, this can be misleading – as the benefits provided to members can be through different conduits – members as owners versus members as customers. Further, co-operatives provide many non-financial services to their wider stakeholders, whether through sponsorship of local community events, through their role as an employer or through the service proposition that they provide their customers. Additional complexity can be found when considering the potential cross-subsidy issues that arise under the co-operative model, whether inter-segment or inter-generational: for example, whether capital accumulated over many generations should be used today or reserved for future generations.

By acknowledging member ownership as the defining feature of co-operatives, and that the core purpose of co-operatives is to act in their members' interests, the acid test of success for the retail banking divisions of co-operative banks may be simply represented by net member growth. If co-operatives are retaining their current membership and attracting new members, they are by definition acting in the interests of membership and providing benefits that are recognised by the wider society. However, as a standalone indicator, net member growth may ignore underlying effects: the acquisition of new members may be destroying value via the use of loss leaders, whilst existing members may be holding dormant accounts, having taken their business elsewhere.

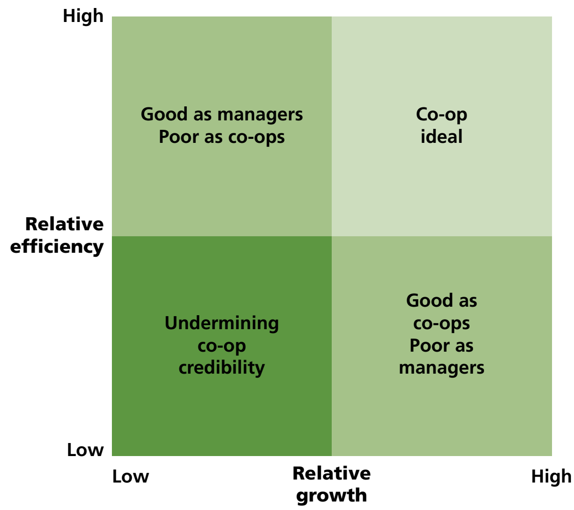
Moving to a further level of detail to address this issue, two factors can be considered as defining co-operative success: cost efficiency and income growth. High efficiency (measured by the cost/income ratio[3] adjusted for local cost factors) relative to competitors ensures that co-operatives are creating the maximum benefit from their available resources, recognising that regardless of whether the "co-operative dividend" is spent on tangible or intangible benefits, there is always an associated opportunity cost. As such, it addresses directly the agency concern that co-operative benefit of cheap capital is being passed on to customers rather than dissipated by management.

High growth (as measured by top-line income relative to competitors) proves that the products and service that co-operatives provide to the market are appreciated by their customers. Further, this measure is independent of the strategies or mechanisms used to generate this growth, recognising that co-operative banks need the freedom to adjust their delivery model to attract and retain their customers. Thus it subsumes the various CSR and other activities of co-operatives – if these are appreciated by members then they will lead to income growth, whether through new members joining, or through winning a greater share of existing members' wallets.

Comparing co-operatives on these two dimensions of growth and efficiency provides a simple framework for analysing performance of co-operatives against delivery of their core purpose. Those co-operatives that deliver high relative growth can be considered as good co-operatives: they are successfully extending the appeal of the co-operative model through more members and deeper member relationships. Those that deliver high relative efficiency can be considered as good managers: they are creating the most economic value from the resources available. Those that score highly on both dimensions represent ideal co-operative performance. Those that score poorly on both are not only failing their members, but also risk undermining the co-operative model by exposing it to the criticism of being insulated from owner and competitor pressure.

3 Under this framework, it is assumed that operating costs and income exclude any non-banking activities resulting from the provision of the "co-operative dividend" (e.g. benefits paid to members, support of the local community) are not recognised in operating expenses

Figure 9: Framework for measuring co-operative performance

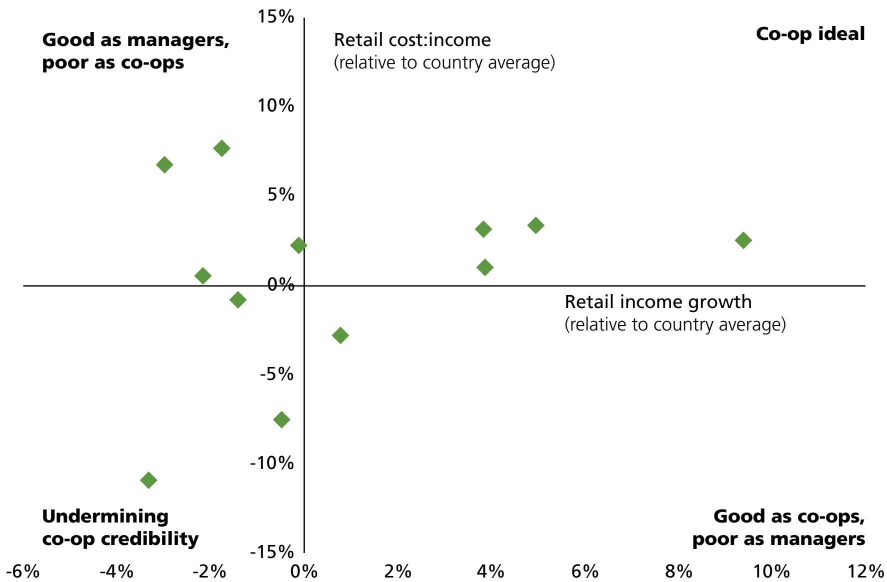


Drawing robust comparisons of performance between co-operative and commercial banks is difficult to achieve given the different objectives these banks pursue and the different business models the employ. Further, drawing comparisons across geographies is also complex when considering that cultural and economic factors differ from country to country.

In an attempt to reduce these potential distortions, the domestic retail banking business of each bank was compared against peers from the same country. By taking the arithmetic difference between the co-operative banking networks average performance over a three-year period (i.e. 2004 to 2006) compared to that experienced by selected peers from the same geography, the relative performance of the institution was estimated. Data was taken from the annual reports of the selected organisations, taking figures for the domestic retail banking division where provided.

Under this framework most co-operatives are shown to be managing efficiently, but many fail to use their unique proposition to deliver strong growth versus the competition. This is shown in figure 10 from the larger distribution of co-operative banking networks above the x-axis (indicating higher relative efficiency) and left of the y-axis (indicating lower relative growth).

Figure 10: Current co-operative performance



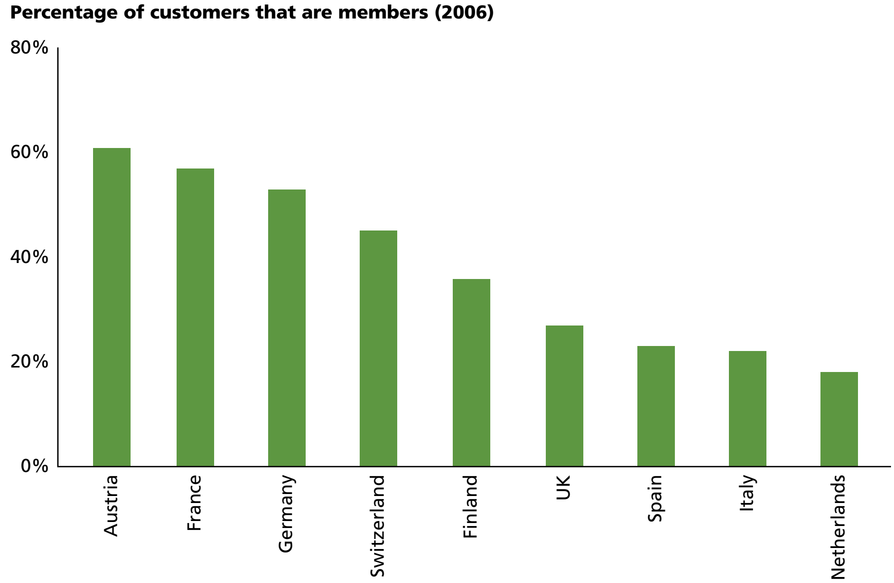
Source: Oliver Wyman analysis

This finding is consistent with the recent trend of improving cost/income performance witnessed across the co-operative banking sector. Using annual report data from BankScope, the weighted average cost/income ratio for co-operative banking networks has fallen over the last 6 years, and in some markets co-operatives lead commercial banks on pure cost/income terms. It is worth noting that there has also been a significant improvement in commercial bank efficiency in the same period as they too use new technologies and processes to reduce their cost base. Nevertheless, a continued focus on improving efficiency will allow co-operative to maximise the benefit they can provide to members and will further demonstrate practical answers to criticisms of an inherent agency problem.

Membership

As mentioned previously, co-operatives' primary mission should be to serve their members. As owners and customers of their bank, the members often contribute capital to the organisation, and in all instances have a lead role to play in the governance of the organisation. However, the attitudes to membership differ across the sector, as witnessed by the percentage of customers that are members across different European countries.

Figure 11: Co-operative membership by geography



Source: Annual reports; bank websites; Oliver Wyman analysis

If co-operative banks are to act as customer champions, they should ensure that their membership represents as wide a swathe of their customer base as possible. Without a dynamic and active membership, co-operatives face an uncertain future: their core purpose is diminished and ultimately their existence is called into question.

There is an inherent danger that co-operatives take a static view of membership, focusing on the current members at the expense of attracting new members. Following such a strategy will result in an ageing membership profile, and as the membership base becomes more distant from the wider set of customers, the appeal of the co-operative will become more niche orientated, setting the bank on a dangerous downward spiral.

To live up to their full potential, co-operative banks should therefore seek to expand membership beyond any self-imposed boundaries. This will enable the delivery of benefits to a wider section of society, drive product and service innovation and ultimately raise income growth.

Widening the membership of co-operatives to appeal to a "broad church" of members requires recognition of different needs and wants. In particular, membership should recognise different customer profiles in terms of relative age, wealth, cultural norms and expectations placed on the bank by its members. With a core purpose built on being the customer champion and tackling asymmetry, co-operatives should seek out those customers for whom the asymmetry is most acute, whether the unbanked, the non-prime borrower, the immigrant, the start-up business or the retiree.

The membership concept should therefore be flexible enough to appeal to a wide range of individuals, examples of which include:

- Offering broader opportunities for members to participate in decision making (e.g. use of assemblies, committees, road-shows)
- Allowing members to select how they benefit as a member of the co-operative (whether directly from economic or social initiatives, or more broadly as a member of society)
- Operating different organisational models to reflect local requirements (e.g. different governance models for urban and rural areas where member participation may differ significantly)
- Using incentives and technology where appropriate to stimulate active membership (e.g. electronic as opposed to in-person voting, donations to local charities in proportion with participation rates)

Most importantly, co-operative banks should regularly review their membership proposition and current membership profile versus the total market to ensure they are achieving broad appeal. This can be done by regularly engaging customers and responding to their feedback. Whilst this is most effective through local channels that hold the relationship with the customers, regional and central organisations also have a role to play by sharing best practices amongst the whole banking network.

Capitalisation

Capital management will continue to be a challenge for co-operative banks going forward. The market crisis occurring in 2007/2008 might suggest that high levels of capitalisation are a good thing. Equally, we might point out that if co-operatives are able to maintain such a high buffer during the bad times, it suggests that they are yet more over-capitalised relative to the good times.

Whilst setting appropriate capitalisation levels and managing against these is a difficult task for nearly all financial services firms in light of evolving and complex regulation, co-operative banks face additional challenges. These stem from the organisational model, in particular the relative large number and small size of the reporting units and the statutes that co-operative banks employ, which may add further restrictions on how co-operative banks can raise and disburse capital.

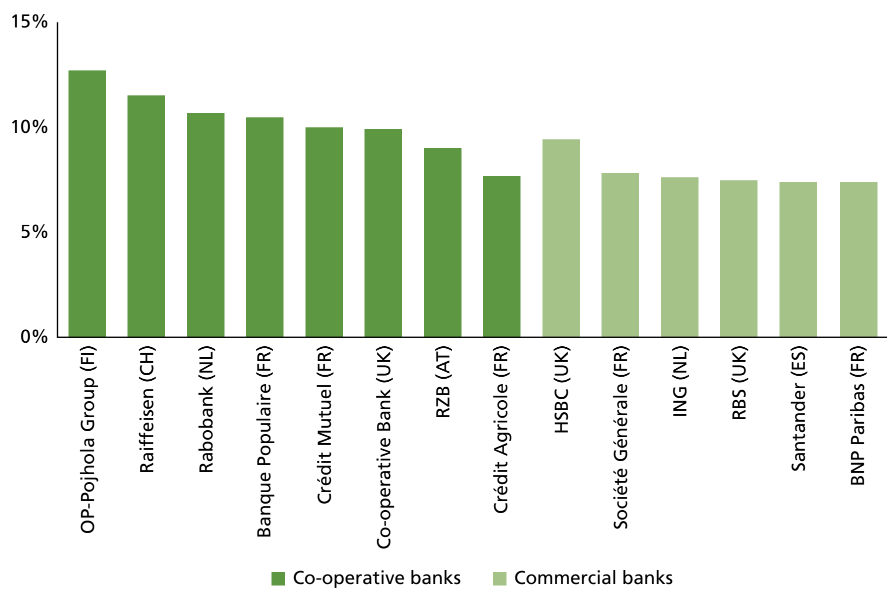
The supply of capital for a co-operative was traditionally limited to the contribution of members and the retention of earnings from profitable activity. Due to this vulnerability, many co-operatives placed sanctions on the redemption of capital by members and were highly prescriptive with regards to the ratio of earnings that must be retained by the organisation.

The demands placed on co-operative capital were also less acute. The pay-out ratios or dividend policies for co-operatives have typically been much more conservative than those of stockholder organisations, recognising members' preference for long-term stability over short-term profit.

As a result, most co-operatives accumulate capital by design. It is therefore no surprise that co-operatives represent some of the more highly capitalised financial institutions in Europe. In most instances, the capital base can be considered as an inter-generational benefit that has been passed from member to member – the contribution of current members is often eclipsed by the level of accumulated retained earnings.

Figure 12: Tier One ratios (2006)

Selected co-operative and commercial banks



Source: Company annual/quarterly reports

Although high capital ratios are beneficial in terms of offering additional stability beyond regulatory minima, there are also drawbacks that co-operatives should consider. Firstly, it should be recognised that capital resources that are not efficiently employed represent an opportunity cost to the economy. By holding excess capital and earning lower returns than can be achieved elsewhere, co-operatives could arguably be stifling economic growth by reducing aggregate savings and investment.

Secondly, there is a danger that by holding excess capital, the management of co-operatives may pursue unnecessary, and potentially value-destroying, expansionary policies. By requiring a lower rate on return on capital employed, co-operatives may be drawn into paying increased prices in acquisition situations or be prepared to take higher risks for lower return than their competitors[4].

As a result of these criticisms, co-operatives that operate at consistently high capital ratios may have to devote increased management time to defend their unique model and ownership structure, whether to regulators, analysts or customers. At the extreme, failure to do so adequately can lead to demutualisation, as witnessed during the 1990s in the UK building society sector.

Co-operatives looking to reduce their capital base have a number of options, which are detailed in Figure 13.

4 For more information, please see the 2007 IMF Working Paper "Cooperative Banks in Europe – Policy Issues"

Figure 13: Options to reduce capital base

Option	Method	Description	Advantages	Disadvantages	Assessment
Disburse excess capital	▪ Windfall dividends	▪ Issue ad-hoc payments to members to reduce capital base	▪ Relatively easy to arrange ▪ Increase member satisfaction	▪ May require changes to statue/law ▪ Rewards current members only – ignores future generations	◔
	▪ Charitable foundation	▪ Divest capital to charitable causes	▪ Tax efficient ▪ Benefits for current and future generations ▪ Positive impact on brand, values	▪ Large endowments will require professional administration ▪ Centralised organisations may undermine local positioning	◔
Utilise excess capital internally	▪ Increase risk appetite	▪ Invest in more capital intensive businesses	▪ Reach new customer bases, increase share of wallet ▪ Increased risk should result in increased profits	▪ Departure from current position requiring support from all stakeholders, rating agencies ▪ Acting outside realm of expertise may lead to poor decision making	◑
Employ capital for expansion purposes	▪ Use capital to fund acquisitions	▪ Investigate investment opportunities in complimentary businesses	▪ Expand business to further leverage economies of scale ▪ Support co-operative movement in other geographies	▪ May result in unnecessary and value destroying empire building ▪ End up paying inflated prices due to lower return objectives	◑
Reduce capital accumulation rate	▪ Increase regular profit distribution	▪ Increase profit pay-out to members via dividends and alternative distribution methods	▪ Opportunity to increase member participation, widen membership base	▪ May undermine co-operative model by moving further to a shareholder dynamic ▪ May raise member expectations that are difficult to sustain through the cycle	◕
	▪ Reduce profitability	▪ Reduce capital growth by reducing profitability via lower margins	▪ Reduce tax burden	▪ Regulator could view as anti-competitive practice	◕

○ = least attractive ● = most attractive

Organisational structure and governance

At their origin, the governance of co-operative banks was relatively straight-forward. An independent bank with a clear common bond to its members, which was linked via profession, location or similarly aligned interests could be governed effectively via a periodic general assembly and the appointment of a supervisory board. This body would elect management to handle day-to-day operations and ratify decisions of particular significance. Whilst agency problems are never totally eliminated, the potential threat of collective action from the local community is always a credible deterrent for managers, thus directing them to act in the interests of members.

These simple building blocks of co-operative governance remain largely intact at a local level, where a general assembly and a supervisory board remain the main method for member representation and participation in the bank's affairs. However, the organisations that members govern are now significantly more complex than they once were. From an internal perspective, most local banks have yielded some decision making power to bodies at a regional, central or national level, whilst management is largely carried out by dedicated professionals reflecting the operational complexity of modern-day banking. Taking an external viewpoint, banks are subject to a greater level of scrutiny than they once were, considering the demands of regulators, analysts, rating agencies and, in some instances, shareholders.

The governance burden on members has therefore increased, and in most cases has been met by corresponding hierarchies of members' representation throughout co-operative banking networks. Provided that these additional tiers enable effective and representative decision making, the emphasis remains on co-operative banks to ensure sufficient member participation at a local level: the key input to the governance process.

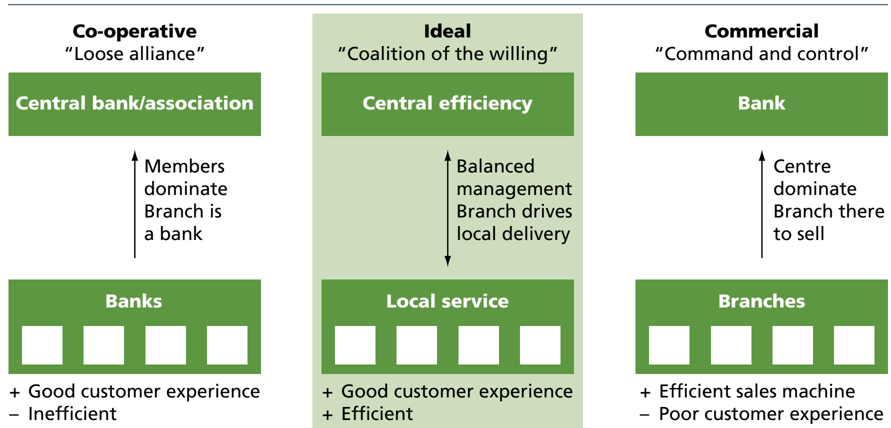
To achieve this, banks should consider a range of different ways to incentivise active participation:

- Educate members about their responsibility via the democratic process
- Communicate the relevance of decisions taken at the general assembly for each individual member
- Use "external" incentives, for example donations to local causes in proportion with the participation rate

The more members participate actively in the local decision-making process, the better their will is represented in the actions of the banking organisation as a whole. This will be achieved via knock-on effects on the internal governance mechanisms, through a wider pool of candidates for the supervisory board and via higher positions throughout the organisation.

Through strong local governance and sense of independence, and recognition of the benefits of the provision of centralised services and functions, co-operative banks will evolve a balance of local delivery and central management. Many commercial banks wrestle with the same trade-off in terms of how far to centralise decision-making from an efficiency perspective whilst allowing adaptation to local requirements. We see a balanced model in evidence amongst some of the best performing co-operative and commercial banks alike.

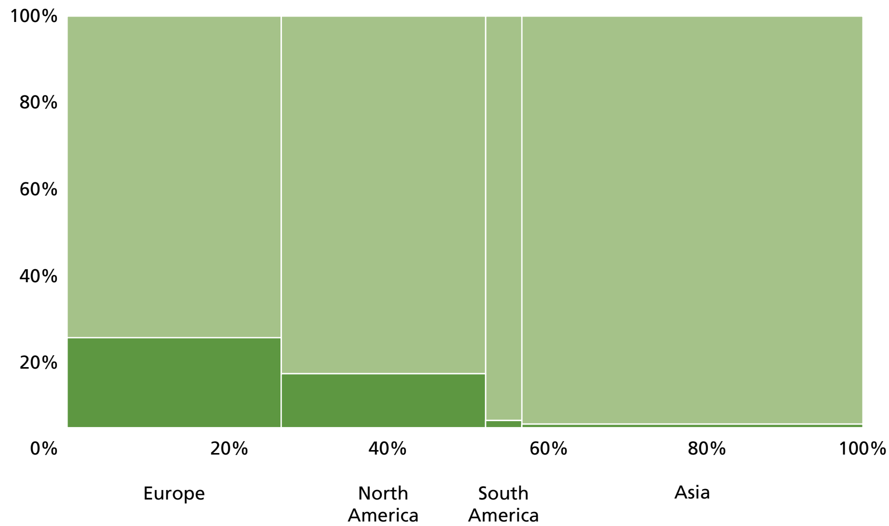
Figure 14: Governance structures under different banking models



Expansion

Looking beyond Europe, there is considerable scope for expanding the geographic reach of the co-operative banking model. Whilst European co-operative banks have captured significant market share in their respective domestic markets, the same success is yet to be replicated in developing markets, such as South America, Africa and Asia. In these geographies, where the provision of banking services, legislation and customer protection are nascent, the co-operative banking model has particular relevance.

Figure 15: Co-operative[1] share of total banking deposits by region



Source: Oliver Wyman analysis

1 Including credit unions and other member-based banking institutions

However, the growth potential of these markets has not been ignored by others, and the competition from both global commercial banks and local players can be intense. In order to compete, co-operative banks need to deploy a clear proposition, an international operating model that complements their existing operations, and exhibit a level of aggression to capture the opportunities from commercial competitors. Such aggression is not normally associated with co-operative banking entities, which usually take a more conservative, consensus driven approach to growth opportunities. But without a more proactive attitude to international growth, the co-operative banking sector is in danger of being left behind as a national model associated with a few European countries, and left behind in the latest wave of international consolidation and the emergence of a handful of global titans.

International expansion has other benefits beside the somewhat circular argument of staying ahead of commercial consolidation. In particular, it can diversify earnings and risk (national central banks are particularly vulnerable to market volatility), it offers the opportunity for economies of scale in areas like manufacturing and asset management. Finally it gives existing members a chance to benefit from participation in new markets with much higher growth rates than those of continental Europe.

To date, the co-operative banks in Europe have explored different international strategies. Rabobank for example, has pursued a set of strategic acquisitions and new business start-ups to become the leading international bank for the food and agricultural sectors, complementing its heritage as the bank for Dutch farmers, and predominantly funded from its capital base. Raiffeisen International (a subsidiary of the Raiffeisen central bank in Austria) has expanded the reach of its retail and commercial banking network into Central and Eastern Europe, primarily funded by selling equity in the venture. Meanwhile, DZ Bank, the major central bank of the German co-operative banking network, has taken a series of strategic investments in the central banks of other European co-operative networks. In each case, the ambition of these international activities is limited and will have little global impact in comparison to the expansion policies being followed by the leading universal banks.

A number of options exist for co-operatives wishing to expand internationally. Inorganic growth through acquisition is possible but may be difficult to achieve without sacrificing co-operative principles. In the first instance, the ambition may be restricted by the size of capital reserves that would be required to fund any potential purchase. To raise additional resources for larger acquisitions, it may be necessary to list part of the organisation, introducing potential conflict between the interests of co-operative members and shareholder investors.

"Hybrid" structures that are designed to balance the needs of different stakeholders do exist (for example the Crédit Agricole Group in France and the OP-Pojhola Group in Finland), however in all cases the primacy of the co-operative part of the organisation is preserved, either through a majority shareholding or controlled voting rights. Regardless, such a conversion may prove unpopular with existing members, and the associated time and costs incurred to effect organisational change may be prohibitive.

Moving beyond these challenges, converting the acquired organisation to a true co-operative form with local members is unlikely to be achieved. The acquiring organisation would effectively have to pay twice for the target, once to buy out the original owners, and again to hand ownership to the current customers. In essence therefore, when co-operatives purchase other organisations, the legacy organisational form and ownership structure are maintained, whilst initiatives may be introduced over time to mimic a co-operative ethos.

Alternatives to inorganic growth include seeding new banking business in new territories under the co-operative model. These typically require investment in new infrastructure, or at minimum the sharing of existing infrastructure with the new local bank equivalent or subsidiary. The pace of such organic growth is likely to be slow however, requiring heavy investment in the education of new potential customers as to the merit of co-operative banking in order to capture the requisite deposits and capital contributions.

Cross-border mergers or co-operation between co-operatives are other feasible opportunities for pan-European consolidation. Although unlikely to raise the profile of co-operatives amongst the wider world, such integration would deliver further economies of scale and strengthen the standing of co-operatives within the financial services sector. Examples already exist in the form of the Unico banking group and payment solutions provider Equens: although the regulatory and cultural barriers are significant, recent developments such as the European Co-operative Society (SCE) provide a new legal form for a co-operative society operating across European Union member states.

Conclusion

Co-operative banks should unite around a core purpose of 'customer champions', building on the platform of member ownership. Good evidence can be found that co-operative values and ideology are appreciated by customers, in particular the relatively high share and growth rate of co-operatives in their home markets. A confluence of market and technological factors which have tipped the information advantage in the banks' favour, make it timely to promote co-operative values under the banner of customer advocacy.

In order to tackle the challenges inherent to the co-operative model and ensure that these values are delivered, co-operative management need to address five issues:

- Execution – ensure you at least match industry norms on growth and efficiency
- Membership – expand beyond self-imposed boundaries to make membership as catholic as possible
- Capitalisation – ensure discipline in managing the capital base and in particular over-capitalisation
- Governance – define common approaches as a target operating model for co-operatives that reinforce the performance and regulatory comfort with the co-operative model
- Expansion – create methods for exporting the co-operative model to new markets and banks

Overall, the mantra should be "commercial delivery of co-operative values." The co-operative model brings an inherent agency problem which many have overcome to lead the industry on growth and efficiency. Those that have not managed this problem need to improve their performance so as not to tarnish the co-operative model as a whole.

Co-operative banks should be seen as a valuable check on the 'regulated commercial' model. Rather than treating co-operative banks as an awkward anachronism, regulators and policy makers should embrace the diversity that these players bring to the financial services industry and the added dimension of choice that they provide to customers.

Moving forward, the European Association of Co-operative Banks (EACB) and local associations have an important role to play, given how much of the customer champion proposition is a public good shared by co-operative banks and requiring common solutions, from communication to capital management, governance and performance improvement.

For further information on this report, please contact:

James Sherwin-Smith, Oliver Wyman, james.sherwinsmith@oliverwyman.com
Mark Weil, Oliver Wyman, mark.weil@oliverwyman.com

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