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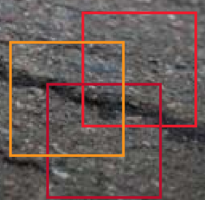
Resilience in a downturn: The power of financial cooperatives



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The power of financial cooperatives

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INTERNATIONAL LABOUR OFFICE • GENEVA

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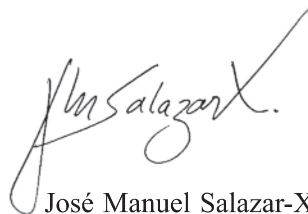
Foreword

Concern for addressing global imbalances and building resilience against crises requires setting out practical policy options available and examining their performance. This ILO report focuses on how financial cooperatives fare in times of crisis, addressing historical, statistical, conceptual, and policy aspects of the question. It recounts how financial cooperatives weathered the storm and came out strong while many investor-owned banks struggled for survival during the global economic crisis.

This report builds on a 2009 report from the ILO, *Resilience of the cooperative business model in time of crisis*, which highlighted the ways cooperative enterprises have shown resilience to the crisis across sectors around the world. The author of the report, Johnston Birchall, a Professor at Stirling University, has been writing on member-owned businesses such as cooperatives and mutuals in the last 25 years. His widely acclaimed book on *People Centered Businesses* (1994) continues to be a key reference for those in search of enterprise models that are closer to people's needs. His 2013 book on *Finance in an Age of Austerity*: *The Power of Customer-owned Banks* looks into the potential of cooperative banks to stabilize the banking sector and provide the basis for a more sustainable economy.

This report provides a timely contribution to the global discussion on alternative approaches to promoting sustainable development goals in the aftermath of the global economic crisis. It shows how the success of financial cooperatives during the global financial crisis can provide a credible alternative to the investment-owned banking system. We hope that it will be of interest to policy makers in partnering with financial cooperatives for enterprise development, insurance against poverty, and decent work.



José Manuel Salazar-Xirinachs
Assistant Director-General for Policy

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Abbreviations

CA	Crédit Agricole
DZ	Deutsche Zentral-Genossenschaftsbank
EACB	European Association of Cooperative Banks
EU	European Union
ICA	International Cooperative Alliance
ILO	International Labour Office
IMF	International Monetary Fund
MFI	Micro-finance institution
ÖVAG	Österreichische Volksbanken AG
RZB	Raiffeisen Zentralbank Österreich AG
SME	Small and medium enterprise
WOCCU	World Council of Credit Unions

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Note about the author

Johnston Birchall is professor of Social Policy at the School of Applied Social Science at the University of Stirling in Scotland. He studied at Oxford and then spent five years as a housing association manager before returning to academic life with an MA in Social Policy and a PhD at York University. For the last twenty-five years his focus has been on the subject of cooperation, more specifically in member-owned businesses (cooperatives, mutuals, and user-controlled public service agencies). He has been at Stirling University since 1999.

Prof Birchall has written several books (with translations into five other languages) his latest being, *People-centred Businesses: Cooperatives, mutuals and the idea of membership* (Macmillan, 2010). His is the author of a number of books published by the ILO including *Cooperatives and the Millennium Development Goals*, *Rediscovering the Cooperative Advantage: Poverty Reduction through Self-help* and a co-author of *Resilience of the Cooperative Business Model in Times of Crisis* published in 2009.

He has a Leverhulme Fellowship for 2012, and is using it to write a book on people-centred banking.

Introduction

The ILO has responded vigorously to the threat of unemployment caused by the 'age of austerity' brought on by the banking crisis of 2008. The 2009 Global Jobs Pact lists several important measures that governments should consider taking, such as support for physical infrastructure, skills development, quality training and education, support for small and medium enterprises, public employment, minimum wages and so on. It calls for action to rectify the causes of the crisis, advocating:

> *Building a stronger, more globally consistent, supervisory and regulatory framework for the financial sector, so that it serves the real economy, promotes sustainable enterprises and decent work and better protects savings and pensions of people*.[1]

The ILO's *World of Work Report 2012* tackles the 'austerity trap' that the advanced economies are in, and says 'it is critical to restore credit conditions and create a more favourable business environment for small enterprises.[2] How can this be done?

The report that Lou Hammond Ketilson and I wrote for the International Labour Office (ILO) in 2009 called attention to the resilience of financial cooperatives in the immediate aftermath of the financial crisis.[3] It found, among other things, that they were still lending to small and medium-sized enterprises (SMEs) when other banks had stopped lending. Now, in the long period of austerity that we are faced with after the banking crisis, we need to understand more fully the potential of financial cooperatives, and that is the purpose of this report.

What do we mean by financial cooperatives? The essential elements are ownership, control and benefit. The customers own the cooperative, with each person having one member-share. Nobody can sell it without their agreement. This does not mean that they should be able to demutualize it; the cooperative does not belong just to the current cohort of members but is an intergenerational endowment held in the business for the benefit of current and future members. Membership is not transferable, and so there is no market for shares. The customers also

[1] ILO, 2009, p. 9.

[2] ILO, 2012, p. 4.

[3] Birchall and Hammond Ketilson, 2009.

control the cooperative. As members, they are an integral part of the governance structure, with powers derived from personal membership; they have one person, one vote regardless of the amount of capital they have invested.

The customers are also the main beneficiaries. The main purpose of the business is to benefit the members rather than to maximize profit. They can expect some of the profits to be distributed to them as a dividend, but this is proportional to the use they make of the business rather than to their investment. Because of the intergenerational endowment, some of the profits also have to go to strengthen the cooperative's reserves.

There are some operating principles that follow from these distinctive features of ownership, control and benefits. The main source of capital for a financial cooperative is retained profits added to reserves. The main source of money for lending to members is member savings. The cooperatives are often part of a network with powerful apex bodies that provide them with mutual financial services. This enables them to remain local while benefitting from economies of scale and scope. Their focus is on long-term relationships with their customer-owners, not on making profits for shareholders.

It follows from these distinctive features that financial cooperatives should be stable and risk-averse. The banking crisis of 2008 was a great test of this hypothesis. With a few exceptions, financial cooperatives have confirmed it to be true. Most came through it without needing any government bailouts, without ceasing to lend to individuals and businesses, and with the admiration of a growing number of people disillusioned with 'casino capitalism'.

The evidence for the power of financial cooperatives in local economic development and job creation is mostly indirect. We cannot prove that, if they are lending to SMEs and micro-enterprises, jobs are being protected and new ones created, though it is a fair assumption.[4] There is a danger of people taking loans for one purpose and using them for another, but among people on low incomes this is not a bad thing: they use loans to smooth out their consumption and survive shocks. Also, their savings act as a cushion, in bad times decreasing the risk of falling into poverty. Underlying these effects is the fact that nobody other than their members profits by the provision of financial services, and that the surpluses made by the business go into the local economy, or are kept in reserves in order to make it less risky.

[4] This is also true of evidence presented for other financial institutions. See ILO, 2002, p. 5 for a discussion of 'indirect job creation' by micro-finance institutions (MFIs).

The report begins by telling the story of how financial cooperatives were invented in Germany in the 1850s, and then grew to be a worldwide movement, with an astonishingly large slice of the global banking market.[5] Then it analyses their performance during and after the 2007-2008 crisis, showing that they have continued to provide banking services to people on low incomes, to stabilize the banking system, to regenerate local economies, and (indirectly) to create employment. The report explains that they are able to do this because of their unique combination of member ownership, control and benefit. It concludes with some policy recommendations for the way governments and development agencies should approach them, not as 'conduits' but as partners in the wider aims of business development, insurance against episodic poverty, and decent work.

[5] The report includes cooperative banks and credit unions, but not banks set up by other cooperatives or building societies. For a fuller picture see Birchall, J, 2010, ch.7.

1. The invention and evolution of financial cooperatives

Like much of what we take for granted in the modern world, financial cooperatives had to be invented. They did not spring fully formed from the minds of the two German social entrepreneurs who are credited with the invention – Hermann Schulze-Delitzsch and Friedrich Raiffeisen – but came together only after several false starts.

THE INVENTION OF FINANCIAL COOPERATIVES

The story begins in 1798, when Henry Duncan became minister of Ruthwell, a small village on the edge of the Solway Firth in South West Scotland. He immediately began trying to improve the lot of his desperately poor parishioners, buying flax for women to spin in their cottages and employing men to turn his land into a model farm or to work on the roads. He revived a local friendly society and imported grain at wholesale prices. Then, in 1810 he decided to set up a parish bank. Local landowners backed him readily; they liked the idea that the poor could save to meet future needs because they would then not be so dependent on parish poor relief! Duncan had rare talents. He had spent three years working in a bank in Liverpool before deciding to become a minister, and so he combined both the impulse for philanthropy and business experience. The idea was simple. People could open a savings account with just six pence. Deposits were held at a local commercial bank where they received five per cent interest, the savers receiving back four per cent. The remaining one per cent was used to provide a charity fund, tiered interest for long-term savers, and a sum for administering the bank. Duncan ran it himself, and instead of taking a salary used the money to build a village school.

The business model was easy to replicate. Within five years of the first bank opening, there were savings banks throughout the United Kingdom. The following year they began to spread to Europe and the United States, and they are now major players in the world banking system.[6]

[6] See Birchall, Forthcoming, ch. 8.

Unfortunately, they had a flaw; they were not really owned by anyone, but administered as trusts by whoever could get their hands on them, and so, until government regulation became effective, they were not very safe. One failed in Rochdale, England, in 1848, and so people began to put their savings into share accounts with the recently opened Rochdale Pioneers consumer cooperative. The cooperative movement became an accidental savings bank for working class people, enabling them to weather all but the most severe recessions; through the rest of the nineteenth century they kept themselves out of poverty without recourse to the dreaded 'poor law'.[7]

One thing the consumer cooperatives would not do was to give credit. A previous cooperative movement that began in Brighton, England, in 1826 had failed through allowing members credit during a recession. This is understandable because it was consumer credit they needed, not credit for productive work; by this time the British working class depended almost entirely on wage labour. In Germany, serfdom had been abolished and a new class of independent farmers was being established, who were becoming more and more dependent on a market system. In the towns, the slow rate of industrialization meant that artisan industry still predominated, protected by their guild system.[8] The farmers and artisans really did need credit.

The catalyst for action was a dreadful famine of 1846 and 1847, coupled with the liberal revolutions of 1848 that convulsed Europe but left aristocratic rulers still in charge. Hermann Schulze was a public legal official in his home town of Delitzsch. During the revolution of 1848 he was elected a member of the Prussian National Assembly, where he presided over a commission of enquiry into the condition of the labouring and artisan classes. This focused his attention on the plight of the tradesmen and artisans of the town. He founded a friendly society to insure people against sickness, and an association to supply raw materials to shoemakers, then in 1850 founded his first credit association. Although it relied initially on capital supplied by rich founder members, it had ten members who were all artisans, and so was a hybrid of a philanthropic society and a cooperative. At the same time, a colleague, Dr Anton Bernhardi, set up a bank in the nearby town of Eilenburg owned by its savers and borrowers, and so in 1852 Schulze modified his own bank to become member-owned. Cooperative savings and credit had finally arrived.

Friedrich Raiffeisen was also a public official, the mayor of a village in the Westerwald, on the right bank of the Rhine in the far west of Germany. The environment was quite different from that experienced by Schulze; instead of the

[7] Birchall, 1994.

[8] Kemp, 1985.

flat lands, large wheat farms and towns of Prussia, it was a mountainous area of forests and small farms and villages. Again it was the terrible famines of 1846-47 that were the catalyst for action. He began by distributing bread and potatoes to the poor, but knew this would not be enough, so he bought flour wholesale and established a cooperative bakery that succeeded in halving the price of bread. He set up a cattle purchase association for the farmers, what we would call an agricultural supply cooperative. He then began to tackle what he saw as the underlying problem of usury.

In 1849, with £300 raised from rich supporters, he set up his first loan bank at Flammersfeld, and then in 1854 a second at Heddesdorf. However, like Schulze he began to see the disadvantages of a bank that relied on philanthropy. As in many such banks before and since, they had problems with repayments; borrowers were reluctant to pay back the loans and the wealthy patrons soon lost interest. In 1862 Raiffeisen set up a third society at Anhausen and made the same transition that Schulze had made from philanthropy to cooperation; here the farmers themselves became the members.

What was so important about combining savings and credit?

In Germany at this time there was a chronic lack of capital, and it was retarding economic growth. Small business people and farmers needed to take advantage of new markets yet the commercial banks, set up to service richer customers, were unwilling to meet their needs. Savings banks were unpopular because they seemed more like charity than self-help. As the historian of the movement, Henry Wolff explained, capital was not equal to the demands made on it. People remained poor through lack of capital, and lacked capital because they were poor. There was a need to find a way to give credit to those who had no security to offer in exchange. Luigi Luzzatti, the great Italian promoter of cooperative banks, talked of the need to find a moral guarantee, a means for the 'capitalization of honesty'. There was an urgent need to find a way of releasing all the productive power that lay latent in the working people for want of capital. For this to happen reformers had to find a way, as Luzzatti put it, of 'aspiring to descend'.[9]

Schulze's system demanded that members subscribe for a single share, the value of which was fixed as high as people could afford so as to provide working capital for the bank, but which could be paid in instalments. Liability would be unlimited, which meant every member effectively stood as surety for the debts of all the others. Profits, after paying a dividend of at least 20 per

[9] Wolff, 1893, pp. 20-23.

cent into reserves, would be distributed to members as a dividend on share capital. The banks would provide share accounts for members' savings, deposit accounts for larger amounts held on shorter notice, and drawing accounts (a forerunner of the modern current account). They granted loans to members with security given in the form of a personal pledge by a relative or friend. Set up on such a complex basis they were meant to be run professionally by a salaried executive elected for three years by a general assembly, overseen by a supervisory board.

Raiffeisen's model did not require share capital. This was because he was aiming his banks at poor farmers, not the relatively affluent artisans and tradesmen of the town. Members had unlimited liability. He insisted on this, even when by law limited liability became available, because he wanted the farmers to rely on each other; while they could put up their farms and equipment as collateral, the main guarantee of commitment to pay off a loan was the involvement all in the debts of each. His strategy for developing the banks was to rely on leadership by the local village priest and to limit each society to one village. He stressed the moral and communal character of the enterprise as well as its financial aims. Profits were not distributed but held in reserves, and loan capital was made up from savings and deposits. As the societies were so small, they only needed one salaried official: a part-time accountant.

Both movements were good at developing regional and national unions, central banks and commercial subsidiaries. Schulze organized the first congress of more than 200 banks that led to the setting up of a General Union, then in 1865 he founded a central cooperative bank. The Raiffeisen movement also set up a central bank and a trading firm supplying machinery, feed, manures, seeds, and coals to farmer-members. Supply associations were also set up in each district, but they were kept independent of the local banks so their business would not become mixed up. A cooperative insurance department was set up to insure cattle, and marketing cooperatives followed in dairying, hops and wine. Credit from the banks meant that these could develop the now familiar system whereby farmers were paid in two stages for their produce, one payment on delivery of the produce and another when it had been marketed.

The genius of Schulze and Raiffeisen was to solve persistent problems in banking for people on low incomes. Knowledge of the credit-worthiness of one's neighbours meant loans were safer. Unlimited liability meant members had a keen interest in monitoring each other. The homogeneous membership base meant peer pressure to repay. There was a strong sense of communal solidarity that overcame the potential conflicts of interest between borrower and saver, and shareholder and manager. The Raiffeisen system was better at this than Schulze's system, but both were much more successful than any other type of business model then invented.

GROWTH OF A MOVEMENT

The Raiffeisen banks made a slow start, but then the movement really took off: by 1905 there were over 13,000 rural banks with nearly a million members. The model was basically sound; Wolff report in 1893 that in 43 years there had only been ten cases of fraud, in every case with losses made up out of reserves or sureties, and there had been no temptation to convert to joint stock company status. However, Schulze and his supporters still had some work to do before their model became stable. The urban banks grew steadily until by 1892 there were around 4500 with 1.5 million members. Conversion to investor-ownership was frequent; for instance, in Saxony in 1889 there were 115 credit associations, but two years later twelve of them had converted. Failures were also too frequent for comfort; in 1892, one authority estimated that there had been 184 failures out of 1910 banks, an attrition rate of nearly 10 per cent.

Wolff said the cause was greed and carelessness; they had taken doubtful bills and lent freely to outsiders (until a law of 1889 compelled them to stop), and had lent carelessly on mortgages. He blamed the way in which Schulze‘s system had put temptation in their way by setting a premium on risky management (1893). The banks failed to provide enough security, and the temptation of high dividends, salaries and commissions were one-sided benefits that in the long run undermined them. It is interesting to note that, in the evolutionary struggle for business survival, the Schulze-Delitzsch associations declined while their rivals grew.[10]

Still, they were fulfilling their purpose. We know a few details about the members of the banks. Around 60 per cent of them took credit, while the rest just used the bank for savings. A wide range of trades was represented but the percentage of hand workers was declining - the banks were becoming more middle class. However, Fay maintained that this was because they had succeeded in making their members better off rather than because they discriminated against working class people.[11] Like the consumer cooperatives all around Europe, they were raising a whole class of people out of poverty and preventing them from falling back into it.

From Germany the idea spread to the neighbouring countries, Austria, Italy, Switzerland, and the Netherlands, then further west to France, Belgium, Spain, Portugal and Ireland, then further north to Finland and Sweden, and east to Poland, Romania, Bulgaria, Serbia, Russia, China and Japan. Then another wave

[10] Op. cit., p. 62.
[11] Fay, 1907.

took it south to Cyprus and Greece. In 1904, the British government in India passed a credit cooperatives act modelled on Raiffeisen's system that was then copied in Sri Lanka, Malaysia, and Singapore. In 1900, Alphonse Desjardins imported the idea to the French-speaking part of Canada, Edward Filene took it from him to the United States, and then in 1930 his associate Roy Bergengren took it back over the border to English-speaking Canada.

From 1941 it was being promoted by Catholic priests in Jamaica, and then the rest of the Caribbean. Jamaican immigrants then introduced them into Britain (a fascinating historical twist of fate, since the great advocate of cooperative banks, Henry Wolff, had failed to interest the British public fifty years previously). By the late 1940s it had reached Australia. In 1955 another priest introduced them into Latin America via Peru. From the 1950s onwards, Catholic activists also began to promote credit unions in several Asian countries, and from the 1960s they began to be promoted actively in Africa through aid programmes. After the fall of the Soviet Union, new sectors were established in Poland and then other Eastern European countries that brought their history full circle; they were reconstituting very old sectors that had been taken over by the state.

The full history of this movement is beyond the scope of this report, but two issues stand out as being in need of further exploration; the relationship between financial cooperatives and governments, and their performance during financial crises.

FINANCIAL COOPERATIVES AND GOVERNMENTS

If they had been asked about what government could do for their credit cooperative movements, Raiffeisen and Schulze would have said, 'Not much'. They just needed it to provide them with a minimum of legal protection. Everything else they did for themselves – audit, supervision, liquidity management, mutual deposit insurance, promotion of new societies, support for SMEs – through using the power of federation. However, by 1895 a shortage of capital for lending on to farmers led the Prussian government to set up a Central Cooperative Bank (known as the Preussenkasse) whose job was to even out demand and supply of money between the regions, and to borrow from capital markets. It was designed as a non-profit with equity from the state and not from the cooperatives. It was 'firmly resisted' by the urban banks but not by the rural banks that needed the capital. By 1923 they were permitted to take an equity stake but with the state keeping control.[12] Similarly, in Austria in 1927 the government provided funding for a central clearing bank for the Raiffeisen movement. In Finland, Okobank was founded in 1902 *before* the founding of a credit cooperative sector, using equity

[12] Meyer, 2012, pp. 97-98.

capital provided by wealthy individuals whose share was gradually bought out by the cooperatives so that by 1920 it had become a genuine cooperative bank.

What these examples illustrate is that financial cooperatives have often been under pressure to accept help, both to get them started and to increase their capacity to lend. A full history of the relationship between the cooperatives and governments would include the 'British-Indian' pattern of colonial support that influenced development in Asia, the founding of agricultural cooperative banks in the United States by the federal government under the 'New Deal', and the incorporation of cooperative banks into the broader system of agricultural co-operation in Japan and Korea. In most cases the relationship was mutually beneficial, but during the post-war period the use of credit unions in Latin America as 'conduits' for on-lending by aid agencies weakened them, and in India government control became pervasive. In China and Vietnam, thriving rural credit cooperative movements were stifled, when they were nationalized.

Now, a reform process is under way to strengthen existing sectors in many countries where they are weak, and to hand them back to their members where they have been captured by governments or overrun by politicians. The successful reform process in Vietnam shows that it can be done. The reform processes in India and China are under way but the outcome is still uncertain.[13] The relationship between governments, aid agencies and financial cooperatives is a complex one. They need each other, but the relationship is fraught with difficulty. It depends on the ability of governments to strengthen and regulate cooperatives without swamping them, and on the ability of the international development community to have patience and allow cooperative systems time to mature. We will return to these issues in Chapter 4.

GOOD IN A CRISIS?

How did the cooperative model stand up to times of crisis?

It survived the First World War relatively intact, but was certainly tested by the great crash of 1929 and the subsequent global Depression. It was tested again in the post-war period by crises that affected particular world regions, such as the Scandinavian banking crisis of the early 1990s. In Germany, a hyperinflation crisis of 1923 weakened all banks, causing them to lose almost all their equity and reserves so that they were unable to lend. However, the cooperatives and the savings banks then gained market share against the investor-owned banks. The town banks remained independent but the rural banks accepted additional government funds channelled from the Preussenkasse through the banks to help farmers survive an

[13] See Birchall, Forthcoming, chs. 3 and 9.

agricultural crisis. Yet in the banking crisis of 1931, the rural banks suffered less than others and so did not need any help from government. The urban banks did suffer losses because their members were unable to repay loans, and some of them had to accept state aid. After making a loss in 1931 they soon came back to financial health. In general, the cooperative banks suffered much less than the investor-owned and savings banks, because they did not take part in the risky ventures (the attraction of 'hot' foreign capital that was later withdrawn) that caused the crisis.[14] The parallels with the recent crisis are remarkable.

In the Netherlands, the vast reserves and conservative banking policies of the cooperative agricultural banks meant they were 'scarcely affected' by the banking crises of the 1920s (though two small regional banks did get into trouble from setting too wide a spread between interest rates on savings and loans). During the 1930s crisis, not one cooperative bank failed, while two that faced difficulties were taken over by neighbouring banks. Strong monitoring by the two central cooperative banks was a key to their success. They consolidated their market position while the investor-owned banks did not. The conclusion is that they had survived the worst of times because of their 'strict credit assessment, solid banking policies and a well-developed supervision structure within the cooperative banking model'.[15] In Austria, during the 1930s all the big banks had to merge or be nationalized, and 'the whole sector could only be saved with enormous state subsidies'. In contrast, the credit cooperatives did not take part in the speculations that got the banks into trouble, and remained close to 'the real economy'.[16]

A pattern is beginning to emerge here, but it does not pay to be complacent; contrast the fates of cooperative banks in Finland and Sweden during the Scandinavian banking crisis of the 1990s. In Finland, cooperative banking began in 1902, taking a place in an already developed market in which savings banks dominated. The cooperatives found a market niche in agricultural lending, and survived the 1930s crisis very well, using their mutual insurance funds to cover losses. In 1970 they became full banks, and began to take market share from the investor-owned banks. In the 1980s, deregulation and the ability to borrow in foreign currencies led to a boom in lending. The ensuing collapse in stock and housing markets, coupled with the economic effects of the collapse of the Soviet Union led to a major banking crisis. The savings bank group made much more risky investments than did the cooperative group. Consequently, it had to be nationalized, and part was sold off to the cooperatives. Around 50 cooperative banks got into trouble, but they merged and then were taken over by their central, Okobank; this has now become the largest retail bank in Finland.[17]

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[14] Meyer, 2012.

[15] Mooij, 2012, p. 122.

[16] Brazda et al., 2012, p. 137.

[17] Kalmi, 2012.

In Sweden, cooperative banks were also founded after the banking system had been fully developed (1915), with a strong savings bank sector already established in rural areas. Again, their mission was seen as the promotion of agriculture, and they only became full banks in 1974. However, they were much smaller than the Finnish sector; before the crisis, they had a market share of only 4 per cent. In the same crisis that afflicted Finland, the cooperative sector sustained losses over several years. The national bank and twelve regional cooperatives merged into one large holding company. The government insisted that it convert to investor-ownership in order to qualify for a bail out and so it floated on the stock market. In 1997 the company merged with the largest of the savings banks and the co-operative sector disappeared.[18]

What lesson should we learn from all these cases?

The cooperative business model is strong, but like any other business financial cooperatives can sometimes fail; there is no substitute for good management and competent governance. We will see in Chapter 2 how financial cooperatives fared in the recent banking crisis.

THE CURRENT SITUATION OF FINANCIAL COOPERATIVES

Taking a global view, we can now see two distinct groups, the European co-operative banks and the global credit union movement, each represented by different trade bodies. The main differences between them are that in the credit unions customers have to be members, whereas the cooperative banks are also able to serve non-members. The credit unions have to restrict membership to

Financial Cooperatives	Credit Unions[19]	European Cooperative Banks[20]
Size	51,013 credit unions (100 countries)	3,874 local cooperative banks (20 countries)
Members	196.5 million	50 million
Assets	US$ 1 563.5 billion	€ 5 647 billion
Deposits	US$ 1 222.6 billion	€ 3 107 billion
Loans	US$ 1 016.2 billion	€ 3 305 billion

[18] See Kornert, 2012.

[19] World Council of Credit Unions (WOCCU), 2012.

[20] Figures for 2010 from the European Association of Cooperative Banks. The Swiss Raiffeisen Federation and the German regional group WGZ are missing from these figures as they are not members of the Association.

people who come within a 'common bond', whereas the banks have no restrictions.[21] In Europe there are twenty countries with between them twenty-four cooperative systems of local cooperative banks topped by an apex federation or bank. Most countries have one each, but France has three and Austria and Italy two. There are (2010 figures) 3874 local banks, with 181 million customers, of whom over 50 million are members. They have a 21 per cent market share of deposits, and a 19 per cent share of loans. They have €5647 billion in assets, €3107 billion in deposits and €3305 billion in loans.[22]

Table 1.1 Basic statistics on European cooperative banks, ordered by market share of deposits in each country (2010)

Country	Central bank	Market share (%) Deposits	Loans (%)	No. of local/ regional societies	No. in millions Customers	Members
France	Crédit Agricole	23.9	21.4	39	20[23]	6.5
	Crédit Mutuel	14.2	17.0	18	29.2	7.2
	BPCE	6.7	7.6	20	7.8	3.3
	Total	***44.8***				
Netherlands	Rabobank	40.0	29.0	141	10.0	1.8
Austria	Raiffeisenbank	29.3	25.5	551	3.6	1.7
	GSVerband	7.2	7.3	60	1.5	0.701
	Total	***36.5***				
Italy	Associazione Nazionale fra le Banche Popolari	26.9	24.7	100	9.6	1.2
	Federcasse	7.3	7.2	415	5.7	1.0
	Total	***34.2***				
Finland	OP-Pohjola	32.5	33.0	213	4.1	1.3
Germany	BVR/DZ Bk	19.4	16.9	1 138	30	16.7
Cyprus	Cooperative Central Bank	19.3	20.4	111	0.7467	0.0634
Switzerland	Raiffeisenbank	18.6	12.1	390	3.0	1.4

[21] Neither of these differences are entirely clear cut, and the common bond is often defined very broadly.

[22] Figures for 2010 from the European Association of Cooperative Banks. The Swiss Raiffeisen Federation and the German regional group WGZ are missing from these figures as they are not members of the Association.

[23] The figure for 2010 is 54 million, which includes customers in several countries, notably Italy and Greece, as well as France. The figure of 20 million is an estimate based on the proportion of customers to members reported in 2008.

Table 1.1 Basic statistics on European cooperative banks, ordered by market share of deposits in each country (2010) *(continued)*

		Market share (%)			No. in millions	
Country	**Central bank**	**Deposits**	**Loans (%)**	**No. of local/ regional societies**	**Customers**	**Members**
Luxemburg	Bank Raiffeisen	11.0	11.0	13	0.1245	0.0075
Poland	Krajowy Zwiazek Banków Spóldzielczych	8.9	5.7	576	7.5	2.5
Hungary	National Federation of Savings Cooperatives	8.6	2.8	112	1.1	0.121
Spain	Unión Nacional de Cooperativas de Crédito	6.6	5.3	80	10.8	2.2
United Kingdom	The Cooperative Bank	5.0	1.5	n.a.	5.1	2.0
Portugal	Crédito Agricola	4.5	3.1	86	1.2	0.392
Bulgaria	Central C Bank	4.1	2.3	30	1.2	0.007
Slovenia	Dezelna Banka Slovenije d.d.	2.7	1.6	n.a.	0.086	0.302
Greece	Association of Cooperative Banks of Greece	1.0	1.0	16	0.431	0.212
Denmark	Sammenslutningen Danske Andelskasser	0.6	0.5	16	0.125	0.063
Romania	Creditcoop	n.a.	n.a.	48	1.1	0.680
Sweden	Landshypotek	n.a.	n.a.	10	0.069	0.058
Total of Europe[24]		**21.0**	**19.0**	**3 874**	**181.1**	**50.4**

Source: EACB 2011, reordered and simplified.[25]

[24] The Swiss Federation is listed separately using 2008 figures.

[25] The Association of Lithuanian Credit Unions has been missed out, because it is already counted in the WOCCU figures (it has dual membership).

Table 1.1 provides basic statistics on the cooperative banking sector in Europe. Each country is listed by order of its market share of deposits, which is one of the most important indicators of success. This is a business model that does not involve a lot of large-scale borrowing from other banks in the market, but relies mainly on generating its own capital for lending on to individuals and small businesses. The fact that in the Netherlands Rabobank has captured 40 per cent of the market shows that the model works. Ten more centrals have more than 10 per cent of deposits, seven more have more than 5 per cent, and another seven have less than 5 per cent.

The number of local banks in each country varies widely, but to get a true picture we have to see the numbers as a ratio of the number of customers. Rabobank in the Netherlands has 71,000 customers per bank while DZ Bank in Germany has around 23,000. The ratio of customers to members is more than five to one in Rabobank but less than two to one in DZ. Most countries have one central bank, but Austria and Italy have two, representing the original split into Schulze and Raiffeisen unions. France has three, because the state-owned Crédit Agricole has been 'mutualized'. The top country is France with a nearly 45 per cent market share of deposits, followed by the Netherlands. When we plot them on a map we find that the countries where the banks have over 10 per cent of the market are the ones where people responded most strongly to the Schulze and Raiffeisen models coming out of Germany 150 years ago. Those with less than 10 per cent seem to fall into two geographical groupings: countries that form an outer ring around Western Europe – the United Kingdom, Spain, Portugal, Greece, Cyprus, Sweden, Denmark – and recently reconstituted cooperative sectors in Eastern Europe – Poland, Hungary, Romania, Bulgaria and Slovenia.

The credit union movement is significant in 100 countries, where more than 51,000 unions have nearly 200 million members.[26] They have a market 'penetration' of nearly 8 per cent.[27] They have US$1563.5 billion in assets, US$1222.6 billion in deposits and US$1016.2 in loans. Collectively the movement is smaller than the European cooperative banks; if we add up the totals for both, the credit unions have around 18 per cent of the total assets, 23 per cent of total deposits, and 19 per cent of total loans. However, they are much more significant than these figures suggest, because they reach down to some of the poorest people in each country and have a substantial economic impact. Here, in brief, is a description of the main characteristics of financial cooperatives by world region.

[26] 196.5 million - unlike the cooperative banks, they are fully mutual, which means all their customers have to be members.

[27] 7.8 per cent - they do not calculate market share but market penetration, which is a ratio of the number of members to the total 'economically active' population between 18 and 64.

Table 1.2: Credit union basic statistics, ordered by market penetration in each region for 2011

World region	Number of countries	Market in penetration percentages	Number of credit unions	Number of members in millions
North America	2	45.0	8 164	104.5
Oceania	5	23.6	326	5.1
Caribbean	19	17.5	433	2.9
Africa	24	7.2	18 221	18.0
Latin America	15	5.7	1 750	18.1
Europe	12	3.5	2 321	8.1
Asia	22	2.7	19 798	39.7
World	100	7.8	51 013	196.5

Source: World Council of Credit Unions (WOCCU), 2012, edited.

If we organize credit unions by the average size of each union, they fall into three types. Africa and Asia have the smallest unions (averaging 985 members in Africa, 2006 in Asia). Then come the middling regions, the Caribbean and Latin America (with 6,804 and 10,335). Then there are the most developed regions, Oceania and North America (with 15,706 and 12,804 members per union). Europe is a bit of an anomaly with only 3502 members per credit union; much of the development in Eastern and Central Europe is recent.

The credit unions have 196 million *members*, which means – assuming that only one or two persons per household are members – that a lot more people depend on them. Which of the seven world regions has the most members? North America leads with 104.5 million, followed by Asia, with 39.7 million, and then Africa with 18.2 million, Latin America with 18.1 million, Europe with 8.1 million, Oceania with 5.1 million, and the Caribbean with 2.9 million members. However, it is all relative to the size of population in each region, and this is measured by WOCCU in what it calls 'market penetration' (calculated by dividing the total number of credit union members by the economically active population age 15-64 years). Worldwide, the market penetration is 7.8 per cent. It is highest in North America at 45 per cent. Oceania is second with 23.6 per cent, and the Caribbean next with 17.5 per cent. Africa has 7.2 per cent, Latin America 5.7 per cent, and Europe only 3.5 per cent. It is lowest in Asia, where it is only 2.7 per cent, which indicates that there is much more to be done in this region by credit union promoters if this model is to have a significant impact on financial deepening.

CONCLUSION

This brief description of the world's financial cooperatives does not include banks owned by other types of cooperatives, such as consumer, agricultural and worker cooperatives (though the best known of these, the Cooperative Bank of the United Kingdom, is included in the EACB statistics). Nor does it include the building societies (known in the United States as mutual savings and loans) that have played such an important role in spreading owner occupation in countries where they are strong. For simplicity's sake it includes only the movement that originated in Germany and then spread throughout the world in the form of cooperative banks, credit unions, and savings and credit cooperatives. It is a dramatic story, made even more urgent by the way this business model has survived and prospered during the recent financial crisis.

2. The effects of the recent banking crisis on financial cooperatives

Immediately after the banking crisis of 2007-08, Lou Hammond-Ketilson and I wrote a report for the International Labour Office that found, in general, cooperative banks and credit unions had come through remarkably well.[28] However, that report was only the starting point for a proper assessment. This chapter begins by asking whether financial cooperatives were more stable than their competitors before the crisis, and whether, if they *were* more stable, this came at the expense of efficiency and profitability. Then it estimates the impact of the crisis on the sector, looking in particular at the losses made by some of the centrals. Then the chapter looks at the situation after the banking crisis, when a more general recession begins to threaten all banks with losses caused by unemployment, default on loans, and loss of savings. Here, the financial cooperatives demonstrate the enduring resilience of their way of doing banking.

PERFORMANCE OF COOPERATIVE BANKS BEFORE THE CRISIS

How well was the sector performing before the crisis?

A study of German banks found that during the 1990s cooperative banks and savings banks had slight cost and profit advantages over investor-owned banks; they were able to obtain funds at lower cost from small savers.[29] A study of banks in fifteen European countries also found that cooperatives were more cost efficient than other banks; they had a better loan quality as a consequence of low risk lending policies.[30] Another study of the EU-15 over 1998 to 2003 compared investor-owned, savings and cooperative banks.[31] It also found that investor-owned banks were, on average, less cost efficient than cooperative banks.

These kinds of studies took for granted that it was possible to compare the different types on the same measures, but this obscures the inherent differences between

[28] Birchall and Hammond Ketilson, 2009.

[29] Altunbas, Carbó Valverde and Molyneux, 2003.

[30] Iannotta, Nocera and Sironi, 2007.

[31] Girardone, Nankervis, Velentza, 2009.

their business models. Fonteyne argued that most literature was flawed as it judged performance of cooperatives with investor-owned banks on just two basic measures - profits compared to inputs.[32] But the business model influences the aims of the bank. Comparing relative efficiency is difficult, since cooperatives pursue a different objective: not to maximize profit but to maximize members' consumer surplus. He found that they were profitable even at low leverage ratios, because their business was quite self-sufficient. They were mainly concerned with recycling savings into loans, and much less dependent than their competitors on money markets. The lower cost of their capital allowed them to pursue other objectives than profit maximization, and they could accept a lower margin on goods and services; value was incorporated into the product. Fonteyne also found that their egalitarian culture was a strong counterweight to excessive management remuneration. He found they had better efficiency ratios, because they made intensive use of a relatively low level of assets to achieve high rates of return.

At the same time as Fonteyne was writing (just before the crisis), two researchers wrote another report for the International Monetary Fund (IMF) that focused on the stability of banks in Europe. It showed that cooperative banks were more stable than investor-owned banks.[33] They used a huge database of 16,577 banks, tracking their progress over a ten-year period to 2004. They took as their dependent variable a Z-score, that measures the probability of a bank's insolvency. The scores for cooperatives were considerably higher than those for investor-owned banks.[34] What made the difference was the *low volatility of returns* over time. They argued that, because they did not have to make profits for shareholders, when the trading conditions worsened they could use their customer surplus as a first line of defence; 'Cooperative banks in normal times pass on most of their returns to customers, but are able to recoup that surplus in weaker periods'.[35]

Just before the crisis, Ayadi and her colleagues from the Centre for European Policy Studies carried out a comparative study of investor-owned, cooperative and savings banks in seven Western European countries, using data between 2000 and 2008.[36] They found cooperatives had comparable or slightly higher earnings than investor-owned banks, and achieved higher return on equity. In terms of *earnings stability*, in all countries other than Germany and Spain, cooperatives were significantly **more stable** than other banks. In some cases the differences were astounding; in France and the Netherlands they were over 50 per cent more stable.[37]

[32] Fonteyne, 2007.

[33] Hesse and Cihak, 2007.

[34] They were slightly but insignificantly higher than for savings banks, which seem to have similar advantages.

[35] Hesse and Cihak, p. 18.

[36] Ayadi, Llewellyn, Schmidt, Arbak, and de Groen, 2010.

[37] As measured by a Z-score.

Table 2.1 European cooperative banks before the crisis: top 12 countries market share and EU totals

Country	Years	Assets (Euros in billions)	Market share of deposits (%)	Market share of loans (%)	Number of customers (millions)
France	2005	1 857	47	53	42.0
	2007	2 443	53	45	67.0[38]
Netherlands	2005	506	39	23	9.0
	2007	571	41	28	9.0
Austria	2005	210	33	29	4.3
	2007	331	36	31	5.1
Italy	2005	492	29	27	9.5
	2007	560	34	30	14.3
Finland	2005	53	32	31	3.1
	2007	66	32	31	4.1
Germany	2005	909	18	12	30.0
	2007	995	18	16	30.0
Cyprus	2005	8.4	23	20	0.6
	2007	9.7	20	22	0.6
Luxemburg	2005	3.4	10	10	0.118
	2007	4.1	10	10	0.1
Poland	2005	8.8	11	9	10.5
	2007	13.3	9	7	10.5
Hungary	2005	4.2	12	4	1.0
	2007	5.0	9	3	1.1
Spain	2005	81	5	5	9.7
	2007	108	5	5	10.3
United Kingdom	2005	16.4	1	0.7	n.a.[39]
	2007	17.3	1	3	2.6
EU totals	2005	4 174.1	19[40]	15	123.5
	2007	5 150.2	21	18	135.8[41]

Source: EACB 2012 reordered and simplified.[42]

[38] This massive increase may be because Crédit Agricole began to report its number of customers world-wide rather than in France.

[39] At this time the Cooperative Bank of the United Kingdom did not have individual members, as customers joined the Group through the retail outlets. A rule change meant Bank customers could join the Group.

[40] The EACB explains that these market share figures are estimates.

[41] The figure provided by the EACB is suspect as Crédit Agricole increased its customer figure from 21 million in 2005 to 44 million in 2007 (moving from counting customers in France to counting customers in several countries). The figure provided in the Table uses Crédit Agricole's 2005 figure instead.

[42] The Association of Lithuanian Credit Unions has been missed out here, because it is already counted in the WOCCU figures (it has dual membership). Totals for 2005 include members in Belgium and Ireland that were not members in 2007, and totals for 2007 include members in Bulgaria, Romania and Slovenia that were not members in 2005. These are small banks so they do not affect the EU totals much.

In summary then, before the crisis cooperative banks were as efficient, or a bit more or less efficient, than their competitors. They were at least as profitable, and in several countries more profitable, but they were everywhere more stable than the investor-owned banks. Table 2.1 compares some key financial statistics for European cooperative banks for the years 2005 and 2007. We can see that in every country assets increased during these two years. For Europe as a whole they increased by over 23 per cent. Market share went down in some countries (Poland, Hungary), stayed the same in others (Finland, Luxemburg, Spain) and in most countries increased. Clearly, the general trend just before the banking crisis of 2007 was upwards.

PERFORMANCE OF CREDIT UNIONS BEFORE THE CRISIS

The first few years of the new century were good ones for the credit union movement worldwide. In 2000 there were over 36,000 credit unions in membership of WOCCU from 92 countries, with over 108 million members. By 2007 there were 49,000 unions from 96 countries, and the membership had increased by 64 per cent to over 177 million.[43] Table 2.2 compares the statistics for 2005 and 2007. Over the two years, the amount of savings increased everywhere by an average of 29 per cent, while loans increased everywhere by 39 per cent. Reserves increased by 26 per cent and assets by 32 per cent. The number of members increased by 13 per cent. Market penetration increased almost everywhere from 6.65 per cent to 7.5 per cent.

Table 2.2 Credit unions before the crisis

Region/ year	Savings (billions of US$)	Loans (billions of US$)	Reserves (billions of US$)	Assets (billions of US$)	Members (millions)	Market penetration (%)
World						
2005	763.8	612.2	91.6	894.5	157.1	6.65
2007	987.9	847.9	115.4	1 181.5	177.4	7.5
Africa						
2005	2.1	2.1	0.1	2.1	9.6	5.7
2007	3.5	3.5	0.2	3.4	15.1	8.4
Asia						
2005	47.6	32.8	4.0	55.0	31.2	2.4
2007	78.0	60.1	4.6	96.9[44]	33.1	2.6

[43] World Council of Credit Unions, 2012a.

[44] Figures for Central Asia were presented separately in 2007, so these have been added to the Asia figures.

Table 2.2 Credit unions before the crisis *(continued)*

Region/ year	Savings (billions of US$)	Loans (billions of US$)	Reserves (billions of US$)	Assets (billions of US$)	Members (millions)	Market penetration (%)
Caribbean						
2005	2.2	1.7	0.34	2.6	1.7	41.0
2007	2.6	2.1	0.35	3.2	1.9	41.4[45]
Europe						
2005	17.7	10.3	1.9	19.9	6.7	2.9
2007	24.8	15.4	2.8	28	8.2	3.6
Latin America						
2005	11.5	11.6	2.5	17	12.4	4.2
2007	19.7	19.8	4.0	30.4	15.1	4.8
North America						
2005	659.2	531.8	80.4	772.1	91.2	41.3
2007	827.5	716.5	100.2	983.0	99.4	43.8
Oceania						
2005	23.5	20.7	2.3	25.8	3.8	19
2007	31.0	28.9	3.3	36.5	3.9	18.5

Source: WOCCU 2012, reordered.

COOPERATIVE BANKS DURING AND AFTER THE CRISIS

After the crisis, two of Rabobank's researchers studied forty-five European banks.[46] They compared the performance of cooperative banks in Europe with their investor-owned competitors on a crucial measure of bank stability called the Tier 1 ratio. They found that, while the market required Tier 1 ratios of 8 per cent, the cooperative banks nearly all had higher ratios than this. Their explanation was that the cooperative banks focused more on retail and added profits to reserves, while their competitors were more diversified and had to distribute profits to their shareholders. The study showed that the average Tier 1 between 2002 and 2007 was 9.2 per cent for the cooperative banks compared to 8.4 per cent for the investor-owned banks, so that they went into the crisis with a strong capital base which they subsequently strengthened. During 2008, Raiffeisen, Rabobank and Pohjola Banks all had over 12 per cent Tier 1, while others strengthened theirs to over 8 per cent.

[45] In 2007 Dominica claimed a penetration rate of 118 per cent that seems implausible. In the 2010 statistics Dominica provides no return. This explains part of the large leap in penetration rates, though there has been a rise overall.

[46] Groeneveld and de Vries, 2009.

By April 2009, the *ratings* for cooperative banks were all still good at A upward, with Rabobank taking the prize as one of the world's strongest banks with an AAA rating. Profitability was lower than for the investor-owned banks, because of the cooperative banks having a higher capital core and lower leverage, which makes them less risky. The study showed that from 2002 to 2008 cooperative banks had a return on equity of 9.3 per cent compared to the investor-owned banks that had a return of 13.4 per cent. This is to be expected because, as we have already noted, cooperative banks do not maximize return on equity in their business model.

Did the absence of a profit maximizing objective make them less efficient?

The study found little difference. They had a cost to income ratio of 62 per cent compared to 61 per cent in the investor-owned banks. They were more efficient than their competitors in every country except France, where they were the same.

The financial stability of cooperative banks was substantially higher than that of the investor-owned banks: in 2007 their average Z score was 54 over 41. They entered the crisis with larger buffers, and then proved to be very stable.

What about their losses?

They had limited exposure to toxic mortgages, and the volatile wholesale banking business. Their write-downs and losses between 2007 and 2008 were bearable; as a percentage of equity they were 6 per cent at Crédit Mutuel and Rabobank, 9 per cent at Banque Populaire, 14 per cent at DZ and Crédit Agricole, and 15 per cent at RZB. There is a question mark over Crédit Agricole, and those banks that have substantial business in central and Eastern Europe have suffered losses in these operations. The lesson from all of this is that those that remained true to their traditional business model came through the crisis much better.

A more recent report from Rabobank has confirmed this positive picture.[47] Cooperative banks accounted for 7 per cent of all the European Banking Industry write-downs and losses between the third quarter of 2007 and first quarter of 2011, even though they had 20 per cent of the market. This is because of their limited exposure to sub-prime mortgages, and fewer investment activities. It confirms that the strengths of cooperative banks are continuing to be evident, but also that their profitability has improved. Between 2003 and 2010, they had an average return of 7.5 per cent, while the investor-owned banks had a return of only 5.7 per cent.

Table 2.3 summarizes the situation of cooperative banks in Europe at two key points, 2007 and 2010. Their assets grew by nearly 10 per cent over the three

[47] Rabobank, 2011.

Table 2.3 European cooperative banks during and after the crisis: Top 12 countries by 2010 market share and EU totals

Country	Years	Assets (Euros in billions)	Market share of deposits (%)	Market share of loans (%)	Number of customers (millions)
France	2007	2 443	53	45	67
	2010	2 671	45[48]	46	91[49]
Netherlands	2007	571	41	28	9
	2010	653	40	29	10
Austria	2007	331	36	31	5.1
	2010	320	37	33	5.1
Italy	2007	560	34	30	14.3
	2010	662	34	32	15.3
Finland	2007	66	32	31	4.1
	2010	84	33	33	4.1
Germany	2007	995	18	16	30
	2010	1 020	19	17	30
Cyprus	2007	9.7[50]	20	22	600k
	2010	20	19	20	747k
Luxemburg	2007	4.1	10	10	100k
	2010	5.9	11	11	125k
Poland	2007	13.3	9	7	10.5
	2010	17.6	9	6	7.5
Hungary	2007	5.0	9	3	1.1
	2010	5.1	9	3	1.1
Spain	2007	108	5	5	10.3
	2010	119	7	5	10.8
United Kingdom	2007	17.3	1	3	2.6
	2010	51.8[51]	5	1.5	5.1
EU totals	2007	5 150.2	21	18	158.8
	2010	5 647.3	21	19	181.1

Source: EACB 2012 reordered and simplified.

[48] Market share for Crédit Agricole is no longer reported, so the 2008 figure is used.

[49] This massive increase may be because Crédit Agricole began to report its number of customers world-wide rather than in France.

[50] This figure is domestic only, i.e. the local banks' assets.

[51] This big increase in assets, market share and customers reflects the Bank's takeover of Britannia Building Society.

years, going down only on one country, Austria. Their market share of deposits and loans remained roughly the same, but the number of customers grew by 14 per cent. Table 2.4 goes into more detail over four years during and after the crisis. Assets dropped, presumably because of losses and write-downs during 2009, but then they recovered so that the 2010 total is nearly 10 per cent higher than in 2007.

In *Germany*, the local banks in the Group have not suffered much, because their business model is fairly conservative and they have not been left holding toxic assets. The Central, DZ Bank, was caught out; it lost around €1 billion in 2008 (though it returned to profit in 2009) and had to reorient its activities more around its core business of supporting cooperatives.

In *Austria,* again the conservative business model has helped the local cooperative banks. However, the central banks have suffered from exposure to deteriorating conditions in Central and Eastern Europe, where lending tends to be more risky. The wider recession provoked by the banking crisis hit these countries in 2009, and default rates have soared. Many foreign banks operating here have also incurred heavy losses. The Volksbank central, ÖVAG, had to ask for government support with an equity injection of €1 billion, and guarantees for its bonds issues. Table 2.3 shows a decline in assets in Austria. Has the policy of seeking profitable banking business in other countries been a mistake? Should the Volksbanks have stuck to the conservative business model of just serving their members?

In *Italy*, the crisis has had very little effect on the cooperative banks, but the impact of the wider recession is expected to be greater, as borrowers begin to default, but the figures for 2010 show continuing increases in assets, deposits and loans in both cooperative groups.

In *France*, losses have been incurred, but they are relatively modest. In October 2008, at the height of the crisis all three banking groups accepted help from the government. Crédit Agricole received €3 billion, Crédit Mutuel €1.2 billion and Banques Populaires €950 million in the form of subordinated debt, calculated in line with the size of the banks' balance sheets and market shares in customer loans and deposits.[52] All these banks have large investment arms that lost money. A comparison of the 2007 and 2010 statistics from Table 2.3 shows that the three groups taken together lost 8 per cent of market share in deposits, but kept up their share of loans and managed modestly to increase their assets. By early 2010 Crédit Mutuel and Crédit Agricole had repaid their loans, and all three groups are now growing again.

In the *Netherlands*, Rabobank was the only large bank that did not need government support. It did have some exposure to toxic instruments but the results from

[52] Ayadi et al., 2010.

the member banks were enough to deal with the losses. Table 2.3 shows it holding its market share at the end of 2010 while increasing its assets. Its Tier 1 ratio had increased from 10.7 per cent to 15.7 per cent, which makes it very strong.

In *Spain*, cooperative banks have been damaged more by the wider economic crisis that was triggered by the banking crisis. Going into the crisis they limited their exposure to the real estate and construction sectors, and during it were better at getting loans repaid than the other banks. At the end of 2009 their non-performing loan rates were much lower those of their competitors. This may have to do with the kind of relationship the cooperatives have with their borrowers. Their ability to screen potential borrowers and monitor their progress in paying off a loan are distinct informational advantages that are more apparent in an economic downturn.

In *Finland*, the impact on the central bank, OP-Pohjola, has been felt through its subsidiaries in investment and life insurance rather than in its banking business. In 2007 its return on equity was 13.7 per cent, but in 2008 this reduced to 4.1 per cent, recovering in 2009 and 2010 to 6.8 per cent. The losses were due mainly to poor investment performance on the insurance side.

Table 2.4 Effects of the banking crisis on European cooperative banks over four years

Years	Assets (Euros in billions)	Market share of deposits (%)	Market share of loans (%)	Number of customers (millions)
2007	5 150.2	21.0	18.0	158.8
2008	5 581.5	21.0	19.0	176.5
2009	5 523.7	18.8	20.1	176.0
2010	5 647.3	21.0	19.0	181.1

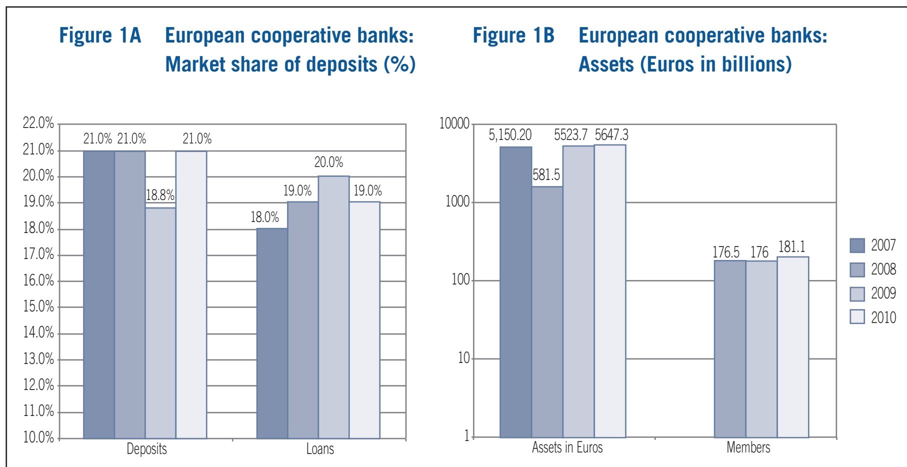


Figure 1A European cooperative banks: Market share of deposits (%)

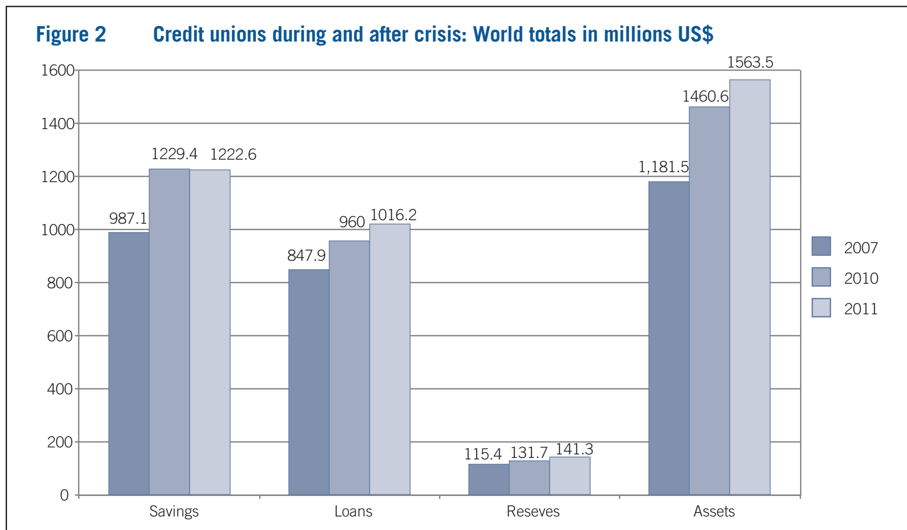
Figure 1B European cooperative banks: Assets (Euros in billions)

In general, the European cooperative banks have come out of the crisis very well. Seven of them are in the top 50 safest banks in the world, and across Europe, they exceed the minimum legal capital ratio requirement of eight per cent, with an average ratio of about 9 per cent. This is reflected in very good credit ratings, which range between AA- and AAA for the largest cooperative banking groups.

CREDIT UNIONS DURING AND AFTER THE CRISIS

For credit unions, the worldwide picture is one of strong growth during the period from 2007 to 2010 (Figure 2).

Figure 2 Credit unions during and after crisis: World totals in millions US$



There has been a slight decline in the number of credit unions (reflecting increasing mergers between unions) and a slight increase in number of members, but the real change has been in terms of performance (Table 2.5).

Table 2.5 Credit unions during and after the crisis

Region/ year	Savings (billions of US$)	Loans (billions of US$)	Reserves (billions of US$)	Assets (billions of US$)	Members (millions)	Market penetration (%)
World						
2007	987.9	847.9	115.4	1 181.5	177.4	7.5
2010	1 229.4	960.0	131.7	1 460.6	188.0	7.5
2011	1 222.6	1 016.2	141.3	1 563.5	196.0	7.8
Africa						
2007	3.5	3.5	0.2	3.4	15.1	8.4
2010	4.7	4.8	0.3	5.8	17.0	7.6
2011	4.3	4.2	0.3	4.9	18.0	7.2

Table 2.5 Credit unions during and after the crisis *(continued)*

Region/ year	Savings (billions of US$)	Loans (billions of US$)	Reserves (billions of US$)	Assets (billions of US$)	Members (millions)	Market penetration (%)
Asia						
2007	78.0	60.1	4.6	96.9[53]	33.1	2.6
2010	107.7	80.7	7.8	139.4	37.8	2.6
2011	121.8	88.1	8.6	140.2	39.7	2.7
Caribbean						
2007	2.6	2.1	0.35	3.2	1.9	41.4[54]
2010	3.9	3.3	0.42	4.8	2.8	16.6
2011	4.3	3.5	0.54	5.2	2.9	17.5
Europe						
2007	24.8	15.4	2.8	28	8.2	3.6
2010	22.1	13.0	3.1	25.4	8.3	3.5
2011	22.3	11.9	3.1	24.6	8.1	3.5
Latin America						
2007	19.7	19.8	4.0	30.4	15.1	4.8
2010	29.2	30.6	6.9	48.1	15.7	5.0
2011	33.5	30.5	7.3	50.3	18.0	5.7
North America						
2007	827.5	716.5	100.2	983.0	99.4	43.8
2010	1 015.7	784.5	108.4	1182.8	102.5	44.1
2011	968	808.8	114.8	1253	104.5	45.0
Oceania						
2007	31.0	28.9	3.3	36.5	3.9	18.5
2010	46.1	43.2	4.7	54.2	3.8	17.3
2011	68.4	69.1	6.6	85.2	5.1	23.6

Source: WOCCU 2012a, reordered.

Savings increased by only 1 per cent in 2008 but then by 15 per cent in 2009, and another 7.3 per cent in 2010. This is an increase of almost a quarter on 2007. Loans decreased very slightly in 2008 then grew by 7.6 per cent and 5.3 per cent over the next two years, making a total increase over the three years of more than 13 per cent. Crucially, reserves increased by over 14 per cent, indicating that the system is in good health and that risks are being kept low. The post-crisis downturn has begun to affect savings, but all the other indicators show continued good health.

[53] Figures for Central Asia were presented separately in 2007, so these have been added to the Asia figures.

[54] This figure is too high, because some countries counted multiple memberships and youth memberships. It declines to 23.4 per cent in 2008 and 18.9 per cent in 2009. From 2010 it looks to be more accurate.

In Africa, the banking crisis had a dramatic effect on local economies, not directly through bank losses but indirectly, through reduction in global demand, volatility in commodity prices, reduction in foreign direct investment, reduced remittances, and so on.[55] In Sub-Saharan Africa the savings and credit cooperatives or SACCOs had been growing fast, and by 2008 were providing services to nearly 9 per cent of the population.[56] In the immediate aftermath of the financial crisis, there was a reduction in the growth of savings, a scaling down of loans and decline in reserves. Their representative bodies urged caution in admission of new members and stressed adherence to the 'savings first' principle.[57] Taking a longer view, in Africa as a whole during the period 2007 to 2010 savings grew by 34 per cent, and loans by 37 per cent. However, the continued downturn in the world economy has affected the sector, with a slight decline in the indicators for 2011.

In the Asia region, savings dipped by over 8 per cent in 2008, but then increased dramatically in 2009 by nearly 28 per cent. Over the three years to 2010 they increased by 38 per cent. Lending also fell at first, but surged ahead in 2009. Again, 2010 saw a large increase on 2007 of more than 34 per cent. The figures for 2011 show continued modest growth in all areas.

The level of savings in the Caribbean grew steadily to 2010 by an astonishing 50 per cent and loans by 57 per cent. Here, as in Africa the amount of business done is very low by the standards of richer countries, but because the penetration rate is much higher the unions are having a much greater effect on the local economy. However, again the 2011 statistics show a levelling off in the rate of growth.

In Europe, during the four years to 2010, savings and loans both declined slowly year by year, and savings are now 11 per cent lower and loans 16 per cent lower than in 2007. The explanation is simple and can be summed up in one word – Ireland. Here, in 2007 the penetration rate was an incredible 104 per cent, indicating that virtually every adult citizen was a member. By 2010 savings had dropped by 19 per cent and loans by 27 per cent. Loan arrears increased from 6.5 per cent of total lending to 17.6 per cent.[58] Clearly, if a country has a big credit union sector and then goes into deep recession the sector will take its share of the pain (though the commercial banks are doing much worse). In Poland, savings have increased by 63 per cent and loans by 57 per cent over the same period, and from a low start, other unions in Central and Eastern Europe are also doing well.

[55] Allen and Maghimbi, 2009, section 2.3.

[56] WOCCU statistics for 2009.

[57] Allen and Maghimbi, 2009, section 3.1.

[58] Carroll, McCarthy, O'Shaughnessy, 2012.

In Latin America we see a loss of savings in 2008 (11 per cent) followed by a dramatic surge in 2009 (45 per cent) and continued growth (over 16 per cent) in 2010, which means overall a growth of 48 per cent over the period. There has been a very slight decrease in loans from 2010, but all other indicators are strengthening.

In North America, during the first year of the banking crisis, the credit unions recorded modest increases of 2.8 per cent in savings. Then in 2009 these leapt up by 13 per cent, and then again in 2010 by 5.6 per cent making a 23 per cent increase over the three years. Clearly, customers were choosing to put their savings in a safer place than the big investor-owned banks. They also continued to keep up their level of lending; in 2009 when the banks were ceasing to lend to anyone they increased theirs by nearly 6 per cent. The 2011 figures show a slight downturn in savings due to the recession, but all the other indicators are healthy.

It is the job of the central cooperative banks and credit union centrals to reinvest surplus cash from the local banks and unions. In Canada, SaskCentral and Desjardins both had significant losses on their investments. However, for the US centrals the situation was much worse. They had been investing heavily in the kinds of toxic assets that the American banking system had been so good at producing until the crisis broke. At the time the investments were rated as low risk products, but the consequences were dire. Five corporate unions were put into conservatorship by their regulator. These held 70 per cent of the entire corporate system's assets and 98 per cent of the investment losses.[59] As a result, member unions are now having to pay an increased insurance premium to a National Share Insurance Fund to help pay for the losses. We can see the damage done by looking at 2009 statistics for the federally insured corporates. Their total assets declined from US$96 billion in 2007 to US$60 billion in 2008, recovering to US$71 billion in 2009. Total capital declined from US$6 billion in 2007 to minus US$2.6 billion in 2008, recovering slightly to minus US$2.3 billion in 2009. These statistics do not include Federal Central that was in liquidation at the time.

Like the Asian region, Oceania's savings rate dipped in 2008 (by 12 per cent), increased dramatically in 2009 (by 36 per cent) and then kept on increasing, so that over the period they increased by nearly half (49 per cent). A similar story can be told of loans. First they dropped by 14 per cent, surged ahead by 40 per cent and then again in 2010 by 24 per cent. The increase over the whole period was by nearly half (49 per cent). The figures for 2011 show a huge leap forward in all aspects of the credit union movement, from financials to membership and

[59] National Credit Union Authority, 2010.

market penetration. Clearly, here the unions are not just weathering the financial downturn but taking a lot of business from the investor-owned banks.

CONCLUSION

Before the crisis, financial cooperatives were competing successfully against investor-owned banks. During the crisis, in general they were not badly affected, though losses were made by central banks in several countries. These were mainly due to investment in derivatives that, before the crisis, had been passed by the rating agencies as safe. Only in a few places did these central banks have to accept government assistance, and, rather than being allowed to fail, weaker cooperatives were mainly taken over by stronger ones. Most of the losses incurred were made up quite quickly, within a year or two, though in some countries primary cooperatives had to bail out their centrals. Now, after the crisis nearly all the indicators show that they have bounced back and are growing again, though not at the same pace as before the crisis; the worldwide economic slowdown and the Euro crisis are to blame for that. There must be something about the customer-owned business model that makes it so resilient in a downturn. The next chapter will make more systematic the advantages and disadvantages of these banks to their members and to the wider society.

3. The advantages and disadvantages of financial cooperatives

So far we have recounted the history of financial cooperatives and reviewed the evidence concerning their performance before, during and after the banking crisis. At various points it has been claimed that they have comparative advantages when compared to other kinds of bank. This chapter provides a more systematic understanding of the advantages and disadvantages.[60]

What does it mean to be a member of a financial cooperative?

There are three aspects: *ownership, control and benefit*. Ownership rights mean that one has power to decide if a business continues to exist, is sold off or wound up. This is why, even when members do not have any control over a business it cannot be sold without their permission. Ownership usually gives control rights, even if these are attenuated by rules and practices that allow boards to operate with very little input from members. At the minimum, members have the right to vote on new appointments to the board and to approve annual accounts. Ownership also confers a right to share in the benefits accruing from the business and also to have a say in how these benefits are allocated. Because cooperative banks and credit unions tend to federate and to create jointly owned central banks and subsidiaries, we have to add in the advantages of scale and scope that come from being part of a larger system. Finally, there are significant benefits to the wider society from having a customer-owned financial sector.

It is not enough to say that there are advantages from being a cooperative; they need to be compared to other types of financial institution that may have similar advantages. The comparison with investor-owned businesses is implicit in the argument set out below. However, there are two other types of financial institution that should be considered: savings banks and micro-finance institutions. A detailed study of the advantages of cooperative banks would have to take into account the relative advantages of these competitors.[61]

[60] Birchall, 2010.

[61] For such a study, see Birchall, Forthcoming, ch. 8.

Some recent reports have distinguished between shareholder-owned and stakeholder-owned banks, aligning European cooperative banks with savings banks.[62] The savings bank sector is very large, especially in Western Europe where it has 19 per cent of banking assets. It is particularly strong in Spain (39 per cent of assets) and Germany (35.5 per cent), where it competes head to head with the cooperative banking sector.[63] In less economically developed countries, the main competitors to financial cooperatives are other types of micro-finance institution. They consist of a range of ownership types, the differences between which are often ignored in the literature.[64] A systematic comparison is beyond the scope of this report, but is worth noting that the Grameen Bank's system has several features in common with financial cooperatives, especially in its revised version, Grameen II.

OWNERSHIP

The advantages derived directly from ownership should apply even if there is minimal member involvement in decision-making.[65]

Advantage 1: It corrects market failure

Ownership of the means by which a good or service is produced prevents ownership by a different interest group that might exploit the economic weakness of individual members. Another way of putting this is that without the financial cooperative existing there would be 'market failure'. At the founding stage this is important. There is the danger of monopolistic supply by moneylenders. Even when there is more competition among suppliers of capital, there is the danger of 'lock in'; here suppliers can exercise control over producers through supplying credit. This is particularly serious for small farmers who rely on short-term credit to tide them over the season.

In the nineteenth century, cooperative banks in Europe, followed in the twentieth century by credit unions worldwide, provided small businesses with the credit they need when commercial banks were unwilling to lend. In the less economically developed countries, these ownership advantages are as relevant now as they were then. Financial deepening depends heavily on credit unions becoming established, since the costs to conventional banks of serving the poor make this sector unprofitable and the only alternative is monopolistic supply by moneylenders.

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[62] Groeneveld and Llewellyn, 2012.

[63] The latest figures are for 2006 from the World Savings Bank Institute, found at www.wsbi.org.

[64] E.g. ILO, 2002, but see Balkenhol, 1999, for recognition by the ILO of the value of credit unions.

[65] See Hansmann, 1996.

Of course, this built-in advantage of financial cooperatives only applies if they are well managed and are not subverted by their managers, or by interest groups such as politicians or local elites. The danger of this is worse in other types of financial institution. Savings banks are 'non-owned', in that neither the customers nor a separate group of shareholders are owners, and a variety of interests are represented on their boards. During the banking crisis, savings banks in Spain and regional public banks in Germany (that are part-owned by savings banks) were found to be unsound because politicians had influenced lending decisions. In the less economically developed countries, non-governmental organizations (NGOs) that provide micro-finance have been criticized for being unaccountable to their clients.[66]

Advantage 2: It prevents a conflict of interest between owners and customers

Economists have long ago identified the relationship between a bank's shareholders and its customers as an 'agency problem'. Equity shareholders may prefer a higher risk profile for the institution than would depositors due to the fact that they have limited liability; their potential for profit is unlimited, while the potential for losses is limited. Depositors do not share in the profits, but they do share disproportionately in the risks. In customer-owned banks this particular agency problem is avoided, since the owners and customers are the same people. There is no separate shareholder interest and the banks can be expected to work in the interests of their customers.

In fact, in a retail bank there is no need for outside shareholders. All that is needed is a mechanism for bringing together those who wish to save money with those who need to borrow it; the bank merely recycles the money. In this view, investors are merely 'middlepersons' who take the profits while adding little value to the business. A recent report for Rabobank spells out what it means when cooperative banks successfully put customers at the core of the business. There is a long-term focus on customer value. Healthy profitability is necessary but it is not a goal in itself. The banks operate in local retail markets, so have access to stable sources of funding in customer deposits. Centred on relationship banking, they produce strong local ties and networks. They have an informational advantage that makes them better equipped to assess creditworthiness, so they tend to have higher lending levels than their competitors.[67]

[66] For the evidence see Birchall, Forthcoming, ch.8.

[67] Groeneveld and de Vries, 2009.

However, this advantage is weakened by the availability of government-backed deposit insurance, which protects customers against risk. Ironically, investor-owned banks are now being forced to take out such insurance, and so the interests of shareholders and customers may not be so much at odds. Also, in financial cooperatives there is a difference of interest between depositors and borrowers, though this is a much less severe agency problem than that between shareholders and customers; a good governance system can easily bring the interests into line.

Advantage 3: It provides an efficient, low cost model of banking

Financial cooperatives have a 'dual bottom line', focusing on customer value as well as equity. They can use their comparatively low costs, abundant capital and lack of a profit maximization constraint to pursue expansion.[68] They only need to remunerate the part of capital that is in member shares, and then not generously. Because they do not have to pay external shareholders, they can reduce the margin between the interest rates they charge to borrowers and pay to savers. They can even decide to sell products at below market price, incorporating the anticipated profits into the products. Consequently, they are able to attract a large share of retail deposits, so experience comfortable liquidity, with high deposit to loan ratios.

In good times they become net lenders in interbank markets. In bad times, the reserves can be built up to cushion them against poor performance; the cooperatives simply do not distribute as much dividend to members, or they adjust their prices upwards so as to extract more surplus.[69] It is true that they cannot issue shares in order to raise capital easily and quickly, nor can they rely on the limited amount of capital raised through member shares. However, they allocate virtually all their earnings to reserves that are then used to finance further growth. Their central banks are usually able to issue various forms of hybrid capital, and some of these banks can attract capital via listed subsidiaries.[70]

All of these advantages are shared with savings banks, which helps explain why in Europe the cooperatives and savings banks both have large market shares and have competed successfully with the investor-owned banks. Before the banking crisis, they were criticized by some analysts for unfair competition, because they put investor-owned banks at a disadvantage. However, in countries where they are strong, they have combined to suppress profit margins throughout the banking sector.[71]

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[68] Fonteyne, 2007.

[69] Hesse and Cihak, 2007.

[70] Rabobank, 2011.

[71] Ayadi et al., 2009, 2010.

Advantage 4: It provides no incentives to risk taking

Why are financial cooperatives so much less risky?

They are not under pressure to maximize profits, a pressure that in investor-owned banks often leads to insecure lending and the sale of complex products that pass the risk on. They are more highly capitalized than their competitors. They are under less short-term pressure and are more inclined to adopt a longer-term horizon in their business decisions and lending policies. It is less easy for them to raise external capital independent of their members, and so they avoid reliance on wholesale markets. They are not subject to the pressure from investors for immediate returns, and so a longer-term focus results. Their business strategy is all about relationship building; a number of studies find that cooperative banks are more willing to establish a long-term relationship with their clients, especially with SMEs.[72] They have been found to have a more stable stream of earnings than other types because they are able to use their reserves as a buffer.[73]

It is when customer-owned banks stray from their natural business model that excessive risk-taking begins. Even then, they are better able to cope with losses through the mutual support network provided by their national federations. Unlike the 'too big to fail' investor-owned banks, the biggest cooperative banks have been found to be better able to smooth out their gains and losses during the peaks and troughs of the business cycle.[74] Again, this advantage is shared with savings banks and other non-profits, provided they are well governed.

Disadvantage 1: It is not easy to raise capital in a crisis

One consequence of ownership by customers is that it is not easy for cooperatives to raise capital outside the virtuous circle of savings and credit. If they have to open up membership to a separate group of investors – through listing on a stock exchange - then they cease to be cooperatives. If they set up subsidiaries and joint ventures that raise hybrid forms of capital, they run the risk of losing money that their members will ultimately have to pay back. They can raise money from their customer-members through issuing various types of subordinated shares that pay interest but do not carry voting rights, and this helps recapitalize the business in times of trouble. However, they may have to accept that there are limits to their growth. Experts agree that the knowledge that capital cannot easily be replaced acts as a check on risky behaviour. After the banking crisis, this lack of access to outside capital can be seen as a strength not a weakness.

[72] Ayadi et al., 2010.

[73] Hesse and Cihak, 2007.

[74] Groeneveld and deVries, 2009.

Disadvantage 2: It has difficulty incentivizing managers

A related disadvantage is that, because of member-ownership, financial cooperatives cannot align the interests of their managers with those of the shareholders by issuing performance-related share options. There is a potential conflict of interest between managers and members. However, empirical evidence shows that their employees are more likely to be involved in decision-making; they have higher job security, and the chance to work in their own region or community. They are close to the customers culturally, share in the profits, and receive valuable training.[75] In general, they do have flatter pay scales than the investor-owned banks, so it is more difficult to attract talent. However, after the banking crisis the lack of incentives for managers to take risks, and the lack of expertise in sophisticated markets can now be seen as advantages.

CONTROL

By member control we mean enough of a curb on directorial and managerial authority to ensure that the business is run mainly in the interests of members and under their ultimate direction. There are several advantages that members gain from keeping this kind of control over their cooperative.

Advantage 1: It guarantees the advantages that are derived from member-ownership.

The intrinsic advantages of ownership are not guaranteed for long if boards take decisions that are not in the interests of members. The first advantage of member control is, therefore, that it guarantees the advantages that are derived from member-ownership.

Advantage 2: It aligns the interests of members with those of boards and managers, and so is linked to business success.

There is strong evidence that effective member control is linked to business success. In a study of several hundred agricultural cooperatives in India, Shah found that success could be explained in relation to governance. His theory is that there are three conditions for success: the purposes of the organization are central to the members; the governance structure ensures patronage cohesiveness; and the operating system finds competitive advantage in the relationship with members. To achieve these conditions the members have to be in control of

[75] Fonteyne, 2007.

governance.[76] Far from being a check on the success of the customer-owned banking model, member involvement has been one of the drivers of its success worldwide.

Advantage 3: Member control lowers risk-taking and so makes the business more durable

The more members are involved in governance the more likely it is that the organization will avoid excessive risk-taking. The problem in the customer-owned banks that lost money during the crisis was partly one of inadequate member control; they did not understand the riskiness of the investments that were being made on their behalf (but then, nor did the ratings agencies!).

Advantage 4: It provides informational advantages to the bank, enabling it to lend to lower income groups

The fact that the customers are also members, and are involved in decision-making should provide the financial cooperative with an informational advantage. The strong local presence and the proximity of the banks enable them to have a better understanding of the needs and the risk profiles of their customers, and ultimately to overcome the information problem. This enables them to provide credit to lower-income earning individuals and businesses with no or little collateral, because they are able to reduce the transaction costs associated with screening borrowers as well as monitoring and enforcing repayments. In other words, these institutions effectively prevent opportunistic behaviour on the part of borrowers.

Advantage 5: It increases opportunities to pursue ethical aims as well as shareholder value.

The involvement of members creates opportunities for them to pursue other aims than just business success. They can express ethical aims in the way the business is run. For instance, the Cooperative Bank of the United Kingdom has been a market leader in ethical banking, being the first bank to offer free current accounts, pledging that it will not lend to companies that its customers regard as unethical, and so on. Contrast the cases of unethical behaviour of bankers in the investor-owned sector in recent years, and their disastrous effects on the world economy.

[76] Shah, 1996.

Disadvantage 1: Members may not be motivated to participate in governance

Member control is not easy to achieve, but it is not as difficult as economic theorists used to believe. Their argument went like this: in a cooperative, ownership is dispersed among many members, each of which has an incentive to free ride on the efforts of others. Also, the acquiring of the information and skills needed for effective oversight is costly. Therefore, members will not have control and managers will subvert the business for their own benefit. There are two weaknesses in this argument. First, it rests on an inadequate theory of human motivation that has become completely untenable; people will often take part in governance even if it is personally costly, because they are motivated by 'collectivistic' incentives as well as by individualistic ones.[77] Second, the complex governance structure of cooperative federal systems tends towards stability; the influence of members is ensured through their being represented at all levels. Researchers who have studied them find that they work much better in practice than the theorists would expect.[78]

BENEFIT

The advantages to be gained by members sharing in the benefits of customer-owned banks are not difficult to understand; together they can channel the value added from the business to themselves rather than to investor-owners. Member-owned businesses more generally operate a kind of cost-price mechanism, first charging members a market price for their goods and then, after each trading period, calculating a patronage refund that returns to them any surplus that has been made. In banking this is less obvious, as many financial cooperatives have rules that allocate surpluses to reserves first, before any can be distributed to members as a refund. The 'inter-generational endowment' limits the benefits to existing members.

However, dividends are only one of the benefits that financial cooperatives may provide. Customers benefit from the convenience of having a more extensive branch network, and less drastic rationalization than if they were tied to an investor-owned bank. Those living in rural areas benefit from access to banking facilities they would not otherwise have. Small firms benefit from the relationship with the bank as borrowers. A number of researchers have argued that larger banks are less capable of processing and transmitting the softer forms of relational

[77] See Birchall, 2012.

[78] Groeneveld and Llewellyn, 2012.

information through their hierarchical structures. Locally based banks are in a position to better respond to the needs of small, local enterprises than are larger, less regionally focused banks.[79]

FEDERATION

Financial cooperatives are not alone. They nearly always form federations, which means that for a full understanding of their advantages we have to consider them as a system. Integration as an *interest group* brings benefits such as political influence (that ensures a more appropriate legal and fiscal environment), economies of scale in education and training, a wider sense of community with similar banks, and a common business strategy. Integration as a *business group* enables cost-effective provision of common services such as IT support, data processing, training, accounting, marketing, product development, and representation. It also provides the opportunity to develop a common brand. If the integration reaches the stage of having a central bank, this enables the group to centralize excess liquidity, redistribute it, place surpluses in financial markets, and run a consolidated asset-liability management policy.[80] It also enables the setting up or purchase of subsidiaries to offer insurance, asset management, investment banking, and information technology expertise that local banks could not afford.

The central also cuts down on risk. Local banks and unions have the disadvantage of serving a homogeneous, locally based clientele, but the centrals can expand the range of business thus making the group's collective income more stable. In highly integrated groups they share risks through various mechanisms such as common deposit insurance or a central fund for liquidity support. Frequently, the federal body is granted supervisory powers that provide a common set of standards for local cooperatives to aspire to. It also provides management consultancy and training that keeps up the quality of local banking. However, the centrals may also represent a risk if they diverge from the customer-ownership business model and pursue other objectives.[81]

In some countries, savings banks have also gained this advantage from federation. Microfinance banks such as Grameen tend to opt for the simpler system of one central bank with branches. Where NGOs are competing with financial cooperatives the difference can be seen clearly. In Sri Lanka, for instance the Sarvodaya movement and the Sanasa movement both consist of primary savings and credit societies at village level. However, the central organs of Sarvodaya are controlled

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[79] Ayadi et al., 2010.

[80] Di Salvo, 2003.

[81] Ayadi et al., 2010.

by the NGO, while the Sanasa Bank and its subsidiaries are owned and controlled by the primary societies.[82]

THE WIDER BENEFITS OF FINANCIAL COOPERATIVES

So far we have been identifying the advantages to members, but there are wider benefits from having a customer-owned banking sector. Mostly the evidence for the wider benefits is good, but with two important limitations. First, the evidence for job creation and retention is indirect. We cannot assume that just because financial cooperatives are lending to SMEs and micro-enterprises they are generating employment opportunities. More direct evidence is needed for their impact. Second, most of the evidence that is available is gender-blind. We know that cooperatives can be good at involving women; in Tanzania, for instance, they make up 36 per cent of SACCO membership.[83] On the other hand, women remain under-represented in African cooperatives, and in some countries 'patriarchal norms and rigid gender stereotypes' have led to development workers favouring new women's cooperatives to redress the balance.[84] For instance, in Sri Lanka a women's cooperative bank provides services to 57,000 members through 120 branches, a model that is also being developed in Tanzania.[85] However, before we can say that financial cooperatives benefit women more than other types of financial institutions, we need to collect the evidence.

Here we identify five benefits for which there is good evidence: investment in local economies; lending to SMEs; contribution to financial deepening; benefits to the wider financial system; and ability to link with broader economic development programmes.

Investment in local economies

Sometimes savings banks gather up savings from within a local economy but invest them outside in government bonds, or in faster-growing urban areas. In contrast, financial cooperatives foster local economic development by mobilizing savings, and lending these out to individuals, families, farmers and small businesses in the same area. The provision of banking services in less well-populated areas also helps to stabilize the local economy by persuading people not to emigrate.

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[82] Birchall and Simmons, 2010.

[83] Coop^AFRICA, 2010.

[84] MDG Achievement Fund, 2010, p. 3.

[85] Birchall, 2010, ch. 4.

The banks' ability to develop real relationships in the long term with local businesses is absolutely crucial, as it enables them to lend at low risk to people that other banks would not touch. They also provide a tax base for local government. Because they belong to their local communities, they are not going to leave and reinvest in more profitable areas.

Ayadi et al. have reviewed evidence from several studies that show cooperative banks in Europe have had such a positive effect on local economies. Their own research shows that they have a significant pro-growth impact in Austria, Finland, Germany and the Netherlands. In Germany they have a self-reinforcing effect; more growth enhances activity, which in turn increases growth further. In Austria and the Netherlands, however, a different pro-growth dynamic is at play: co-operatives continue to operate in areas experiencing low growth and so help to limit the damage.

Another important advantage to local communities is the way financial cooperatives enable the sending home of remittances from migrant workers. They are very important in Latin America, where in six countries they amount to more than 10 per cent of GDP. They contribute to the standard of living of some of the poorest people in the most remote areas. Without the remittance system organized by WOCCU, they would have to rely on sending money by human couriers, by post, or by commercial money senders that charge high fees. It began in 1995, when WOCCU helped a credit union in California to send money transfers to unions in El Salvador.[86] Now the international remittance system transfers vast amounts; in 2006, US$267 billion were sent worldwide, of which US$61 billion went to Latin America.[87]

When a financial cooperative sector becomes predominant in a region, we can see the benefits to the local economy even more clearly. The Desjardins Group is the jewel in the crown of the worldwide credit union movement. There are three features that make it special; its sheer size in relation to the banking sector in its region, the complexity of its organization structure, and its strong cooperative ethos. Then there is a fourth feature that comes from these, its socio-economic impact. The only movement that rivals it in these ways is the Mondragon co-operative system in the Basque region of Spain, which has a savings bank at its centre but is organized around a different principle, of worker cooperation. The success of both movements has been explained by their situation; an ethnic group who are in the majority in their region but form a minority within a larger nation

[86] Birchall, 2004.

[87] World Council of Credit Unions, 2012b.

state where the majority speak a different language. The result is a strong sense of social solidarity.

Desjardins is the market leader in the province of Quebec in Canada for nearly all financial services. A major factor in this success story is the tightly integrated and efficient group structure. The 'caisses' or credit union network is served by just one central, Desjardins Group that has a democratic structure of regional general meetings, councils and an assembly of representatives. It has four business sectors, for personal services, business and institutional services, wealth management and life and health insurance, and property and casualty insurance. This structure works well, both as a business and as an association of people. The word 'movement' is a loaded one, and suggests more than just a group of businesses that collaborate together. It suggests a sense of common purpose, of community and of shared values. In this case we do not just talk of a sector but of a genuine social movement that has transformed its regional economy.

Lending to SMEs

An important advantage to local communities is the loans that financial cooperatives give to support local businesses. Take the situation in North America. In

Table 3.1 Some European cooperative banks' market share of loans, ordered by market share of loans to SMEs[88]

Country	Central bank	Market share of loans, %	Market share loans to SMEs, %	SME loans as % of total loans
Netherlands	Rabobank	29.0	43.0	14.0
Austria	Raiffeisenbank	25.5	39.0	
Italy	Banche Popolari	24.7	27.4	48.0
Germany	BVR/DZ Bk	16.9	27.9	26.1
France	Crédit Agricole	21.4	25.0	
	Crédit Mutuel	17.0	15.8	2.0
Poland	KZBS	5.7	14.0	20.0
Luxemburg	Bk Raiffeisen	11.0	8.0	18.8
Austria	GSVerband	7.3	7.4	32.0
Hungary	NFS Coops	2.8	7.8	50.3
Portugal	Crédito Agricola	3.1	5.0	36.9

[88] For 2010, from EACB 2011, reordered – note that some banks do not provide the data.

the United States, business lending is limited to 12.3 per cent of total lending for most credit unions (though loans of less than US$50,000 are not counted against this limit). This does not apply to the community development credit unions that serve low-income and minority communities, and they can access funds for on-lending from the Federal Government. In Canada, the English-speaking credit union sector is the second largest lender to small businesses, with a market share of 18.3 per cent. In the province of Quebec, Desjardins has a 27.9 per cent share of business credit, including 26.5 per cent of lending to SMEs and 42.7 per cent of agricultural financing. Desjardins has its own venture capital subsidiary, which partners with 300 businesses, helping maintain nearly 35,000 jobs.

Table 3.1 shows just how important the European cooperative banks are for lending to SMEs, and what a high percentage it is of their total lending. Rabobank in the Netherlands leads, with a market share of loans to SMEs of 43 per cent. If we compare the share of loans in general with loans to SMEs it is apparent that the latter type is a big part of the cooperative banks' business. Even the banks with a very small percentage of the market make loans to SMEs a major part of their loan portfolio.

Contribution to financial deepening

Financial deepening is the ability to provide people on low incomes with banking services they would otherwise not be able to access. Without a safe place to put their savings and the chance to borrow, the poor are locked into that same cycle of poverty that challenged Raiffeisen and Schulze in Germany in the 1840s. This affects not just them but the whole local economy of which they are a part.

Worldwide, cooperatives are the second biggest banking network, serving 870 million people. 45 per cent of their branches are in rural areas, compared with an average of 26 per cent for all banks.[89] The European cooperative banks are particularly effective; they have nearly 70,000 branches, reaching into all parts of both the urban and rural economies. They have maintained a huge automatic teller machine (ATM) network, while other banks have cut theirs back. The successors to the Raiffeisen movement are particularly good at serving rural communities. For instance, 32 per cent of the branches of the 'banche di credito' (credit banks) in Italy are in areas with fewer than 5000 inhabitants.[90] Competition with other types of bank has meant that in many countries the number of branches

[89] CGAP, 2010.

[90] Op. cit., p. 60.

has been decreasing; in Finland, for instance, it has gone down from 745 in 1997 to 554 in 2010, but the OP-Pohjola Group is still by far the biggest branch network. In some countries, as financial cooperatives have got bigger and become more like commercial banks, supporters have begun to criticize them for losing their original purpose of providing banking for people on low incomes. In the United States, the majority of unions now serve 'solidly middle class' members, but there are 1128 'low-income' unions that deliberately aim to serve financially excluded communities.[91]

Benefits to the wider financial system

Financial cooperatives bring diversity to the banking industry. Diversity is important because it affects the capacity of a society to respond to uncertain future changes. If we see the global economy as a kind of evolutionary, adaptive system then we can expect one type of business to thrive at the expense of another. However, if one type dies out completely then the stock of existing solutions will have declined.

Another advantage of customer-ownership is greater stability in the financial sector. The stability and low level of risk that we have already identified as advantages for members also have implications for the public interest. Countries where the cooperative model is strong are less badly affected during a crisis than countries where the model is absent. Another advantage to the wider economy is the smoothing of the economic cycle. If banks create reserves during the upturn in the economic cycle they can release these during a downturn and help avoid recession. Investor-owned banks have no incentive to do this, and they tend to reward their owners (and managers) excessively during the good times and then ask for bailouts when the going gets tough. As the current Spanish banking crisis illustrates, this is also true of savings banks that are owned by nobody but controlled by politicians. The bursting of a property bubble in Spain has been made worse by the banks continuing to lend on dubious surety so as to delay the downturn. If we have banks that are prepared to create reserves in good times and unlock them in bad times, this becomes a public good.

Linkage with broader economic development programmes

The evidence for the effects of financial cooperatives in development programmes is also impressive. Projects that are designed to strengthen the cooperatives can use the same network to provide agricultural extension, small business development, micro-insurance, and value chain work with farmers. The aim is to integrate

[91] Rosenthal, 2012.

the provision of credit with a wider goal of increasing people's incomes. They have to make sure that they do not undermine people's discipline in paying back loans, by resisting the temptation to pour donor funds into the cooperative. If they keep the core savings and loan function separate, then the wider approach works well. We have to recognize that credit alone does not solve the problems of small farmers and micro-entrepreneurs.

For instance, in Uganda the Canadian Cooperative Association and Uganda Cooperative Alliance are linking agricultural cooperatives and savings and loan cooperatives. In Haiti, WOCCU is working with the United States Agency for International Development (USAID) funding to strengthen value chains along with provision of financial products. There is scope for much more of this kind of development work, linking farmer cooperatives, small business development, and financial deepening. Micro-insurance can be provided through financial co-operatives, provided it does not interfere with the need to manage loan repayments. It makes it possible for people to take loans without fear of saddling their relatives with debts if they become sick or die.

CONCLUSION

The advantages of financial cooperatives are more than just a list; they all act together in a systemic way that amplifies each individual advantage. The disadvantages are sometimes serious, but on balance they are strongly outweighed by the advantages, particularly in a time of financial austerity when we are searching for alternatives to the failed banking system of the past. Now we explore some current issues that financial cooperatives are facing, and then make some policy recommendations.

4. Current issues and policy recommendations

In the economically developed countries, the recent banking crisis is leading inevitably to increased regulation of the banking system by government under a tightened 'Basel III' regime. From the point of view of financial cooperatives that have already proved their soundness, there is the threat of *too much regulation*. In contrast, in developing countries there is often a lack of effective regulation from governments unable to supervise thousands of small societies. Here the threat is of *too little regulation*. In both scenarios, there is the threat of *inappropriate regulation* by governments that do not understand the 'cooperative difference'.

In the past the regulators have proved largely unaware of cooperatives. Writing in 2007, Fonteyne found that Basel II had no mention of cooperative banking, despite this type having such a large share of the European market.[92] Will Basel III be any more informed? As we have seen, financial cooperatives can be very large, and able to deal with new requirements without their costs increasing too much. They can also be very small, and here inappropriately detailed requirements will impose costs that will damage the competitiveness of smaller banks. In the United States, regulators have recognized this issue by exempting community banks from some of their requirements. In other countries, micro-finance laws regulate small cooperatives while large ones come under the banking system.

In addition to a well-crafted regulatory system, financial cooperatives need a sympathetic environment if they are to reach their potential. They need dedicated promoters to set up new societies, and experts to strengthen them; this is best done 'movement to movement', by cooperative apex bodies in countries where they are already well established. They need employer organizations and trade unions to see the potential benefits of employment-based credit unions. Where NGOs are active in promoting micro-finance they should be careful to nurture

[92] Fonteyne, 2007.

sustainable savings-and-credit based cooperatives rather than simply dispensing loans, and they should pay attention to the need for apex bodies that strengthen financial cooperatives as a *system*. Micro-finance investment funds may find co-operatives an attractive conduit for lending, but there is a danger that they may swamp them with credit that undermines their autonomy.[93]

It is difficult to generalize about what financial cooperatives need. The situation varies from country to country and in the degree of maturity of the cooperative system. Here are some typical scenarios that lead to distinct policy recommendations:

Scenario A: A country with a stable, developed financial cooperative system, that has the capacity to expand its support to SMEs

In the aftermath of the banking crisis, governments in the most developed countries are both supporting their banks with massive amounts of cheap credit and beginning to regulate them more closely. When financial cooperatives are offered funding, either for strengthening their capital ratios or for on-lending to SMEs, they should be careful not to allow themselves to be swamped with government money; in the long run they must keep a healthy balance between savings and loans and have an incentive to keep up their own reserves.

Government regulators should recognize the differences between financial co-operatives and investor-owned banks both in their capital structure and their corporate governance. They should understand the network type of organization that the European cooperative banks in particular have achieved, and trust the way in which delegated supervision has worked over the last 150 years! They should not over-regulate, otherwise the cooperatives may find it too expensive to serve low-income members with small savings and loan accounts, and be forced to move upwards towards more affluent clients. It is important for the stability of the cooperative system that local banks are able to make decisions. Without local initiative, the cooperative banking system loses its power to underpin local economies and employment.

Scenario B: A country where an existing financial cooperative sector exists but is not 'aspiring to descend'

Here, promoters of microfinance should engage with the sector to find out why it is not serving the needs of those on low incomes. It may be that there is unfair

[93] For a thorough exploration of this issue see Balkenhol, 1999, pp. 30-32.

competition from microfinance NGOs! They should encourage the sector to find ways of extending its reach, offering financial and technical support for effective loan appraisal and risk management. If the sector is strong enough, loan guarantees can be offered, and access provided to some wholesale funding. If funds are provided for lending on, these should not overbalance the loan portfolio (25 per cent is a good rule of thumb), and they should be seen as a commercial rather than a political initiative. Only those societies that meet prudential loan repayment criteria should receive funds for on-lending.

Scenario C: A country with a rapidly growing sector that has inadequate supervision

Here, promoters should focus on developing the capacity of government regulators and the national federation to supervise the sector. They can use a grading system that incentivizes societies to become stronger. Where there is a new federation, it is prudent to allow only strong societies to become members (as in Dunduliza in Tanzania). Where weak societies are already members they can be incentivized with the offer of economic benefits such as access to electronic networks or guarantee funds if they reach a required threshold. The ones that will not make it might eventually be closed down or merged with stronger societies. Only when they have loan assessment and risk management systems in place can their lending be expanded, and then mainly through use of their own member savings. If the existing law becomes an impediment, the legal framework will need to be updated in consultation with the sector, and using the WOCCU guidelines for credit union law, or the ILO guidelines on cooperative policy and legislation or other guidelines specific to particular types of financial cooperative.

A lot of effort should be put into strengthening the national federation to take the lead in promoting and representing the sector. This is what has happened in Poland and Vietnam and is beginning in Tanzania.

Scenario D: A country where a large financial cooperative sector exists and is politically controlled, but there is an effective reform coalition

Here, new laws will be needed guaranteeing the autonomy of financial cooperatives. The regulatory system will need to be reformed, non-viable societies will have to be closed down, corrupt boards removed from office and fresh elections held.[94] Governments can usefully fund the reform process, and in particular a member education programme and the handing over of societies to their members.

[94] Birchall and Simmons, 2010.

After all of this has happened, all the usual strengthening measures will be needed to ensure the societies become good at banking! This is the kind of process that is going in China with rural credit cooperatives.

Scenario E: A country where a large financial cooperative sector exists and is politically controlled, but there is NO effective reform coalition

If there is no reform, then nothing can be done. Organizations wishing to promote financial cooperatives should focus on creating an alternative system that might emerge out of existing micro-finance projects. This is what happened in Sri Lanka in the 1970s with the Sanasa movement. It could be an alternative in India, if the current attempts to reform the massive credit cooperative sector are stalled.

Scenario F: A country with no financial cooperatives, or a small number of primary societies

Here, promoters should aim to develop a whole sector, with its own support structures of national federation and a central bank. Nothing less will do. Setting up primary societies on their own will just lead to problems that later on will be difficult to put right. National-level structures follow naturally from demands from primary societies for business services, but they should not have to wait too long! In Poland, for instance, the national federation was set up only a few years after work began to establish primary societies, and it was soon self-sufficient.

The aim should be to develop the capacity of the sector largely to supervise itself, and to pay for this out of its profits. That way it will not be vulnerable to cuts in government budgets or changes in policy. Of course, governments will want to regulate and supervise on behalf of savers, but often they do not have the capacity to do this and a lot of delegated supervision will be needed. A law will be needed that regulates the sector, recognizing its unique characteristics as well as what it has in common with other types of bank or micro-finance institution. It is important not to 'reinvent the wheel': there is plenty of guidance provided by WOCCU, DGRV –Deutscher Genossenschafts– und Raiffeisenverband (German Cooperative and Raiffeisen Confederation) and the ILO.

THE RELATIONSHIP BETWEEN FINANCIAL COOPERATIVES AND OTHER KINDS OF DEVELOPMENT

Financial cooperatives can be a base for other kinds of development programmes. Often, they are the only formal organizations available, particularly in remote rural areas. Their members need support, particularly when they borrow money to develop their own businesses; credit carries risks as well as opportunities.

Parallel programmes can be provided that cut down the risks to borrowers while not undermining the cooperatives. In particular, they can be a base for supply chain development. This helps primary producers (farmers, fishers, foresters) to make a better return on their business. It is no accident that, as soon as he could, Raiffeisen set up supply cooperatives for farmers, as well as rural credit cooperatives.

They can also be made into a base for small business development, but without swamping them with external funding, or substituting political decisions for commercial ones. Both the financial cooperatives and the SMEs have to survive in a competitive market.[95] Cooperatives often provide micro-insurance in the form of death benefits; as the promoters of the Grameen system found out, if credit is to be used to its full potential, the knowledge that one's surviving family will not be burdened with the debt is essential. Other types of micro-insurance can be added in, but not provided directly by the cooperative; beyond simple death benefits, the linking of insurance and borrowing can create a moral hazard, but if the linkage is not to the loan but to a potential cause of default - ill health or crop failure or natural disaster – the combination of lending and insuring can keep people out of poverty.[96] External funding can be used to subsidize the insurance side, provided this is insulated from the loan product. We should not forget that savings are also a kind of insurance; they smooth out the peaks and troughs of consumer expenditure and to some extent help businesses to survive an economic downturn. Financial cooperatives should always provide *savings* and credit.

Finally, we should remember that financial cooperatives are not just about financial deepening. Like other types of cooperative, they are 'people-centred' businesses, owned by the people they serve. This makes them more challenging than other types of micro-finance institution to promote, but also much more sustainable.

[95] Adams, 2005.

[96] Clarke and Dercon, 2009.

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