European co-operative banks in 2018: a concise assessment

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This research letter presents consolidated financial indicators of 18 co-operative banking groups in 13 European countries for 2018.[2] It is intended for cooperative bankers, policy makers, regulators and academics. Collectively, the number of members increased sharply by 3.3 percent to almost 85 million. The market shares in domestic retail banking went up by about 0.5 percentage point and reached their highest levels ever. The comparison between key financial metrics of co-operative banking groups and the entire banking sector shows a mixed picture. The average Tier 1 ratio of co-operative banks rose to a record high of 15.9, whereas this ratio declined somewhat to 15.3 for all other banks. The average return on equity did not change compared to 2017 (6.8%). The average cost-to-income ratio of both categories of banks rose by around 1.5 percentage point, partly due to a decline in the net interest margin. As in many preceding years, co-operative banks provided more new loans to the real economy, reported a higher deposit growth, and reduced their branch network and employment to a lesser extent.

Background

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

This document records aggregated financial data of co-operative banking groups which come from public sources or are compiled upon request by some banks. Simultaneously, identical indicators were gathered or constructed from various renowned data bases for national banking systems in which these co-operative banks act. This way, the consolidated financial performance of co-operative banks can be put into perspective, and moreover, it can be compared to that of entire banking systems. For the non-euro countries in the sample, all figures were converted into euro at the exchange rate prevailing at the statement date. It should be stressed that this research letter does not contain a comparative analysis of the equally important non-financial performance of banks and is descriptive in nature.

Uptick in member growth

Members constitute the legitimacy of co-operative banks. In 2018, the member base of co-operative banks expanded remarkably by around 2.7 million. Compared to 2017, the number of memberships grew by 3.3 per cent to 84.8 million. The blue line in Figure 1 shows that this percentage increase is higher than the average long-term expansion of the number of memberships of around 2 per cent per year as depicted by the straight green line. Since 1997, the member base displays an almost continuous rise, except for 2001 and 2009. The red line represents the member-population ratio. This ratio exhibits an upward long-term trend and a marked jump in 2018. In 2018, this ratio surpassed 20 for the first time. On average, more than 1 out of five inhabitants in the 13 European countries under review is now a member of a co-operative bank. The driving forces behind surging number of members are manifold: financial benefits, immaterial advantages, the ambition to participate in internal governance bodies,

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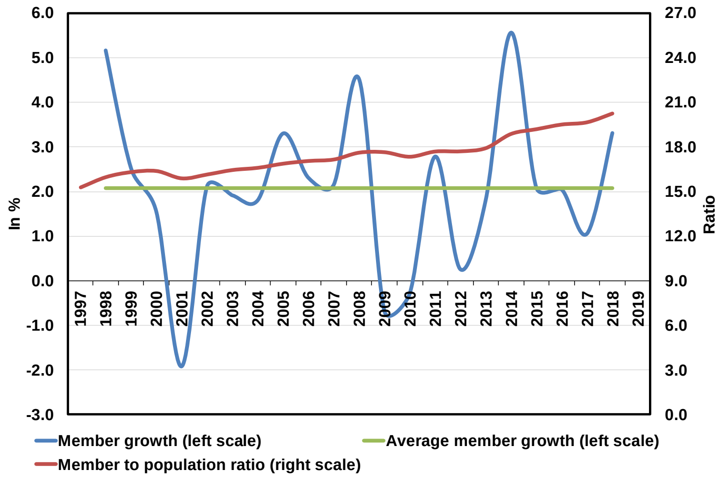
[2] Financial Group of the German Volks- und Raiffeisenbanken (Germany), Austrian Volksbanken Group (Austria), Raiffeisenbanken Group (Austria), Federazione Italiana delle Banche di Credito Co-operativo-Casse Rurali ed Artigiane (Italy), Unión Nacional de Co-operativas de Crédito (Spain), Banco de Crédito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

affinity with the brand, satisfaction with products and services, the pursuance of a dual-bottom approach (i.e. aiming at economic and social objectives), co-operative donations, et cetera. It must be noted that a customer is usually not obliged to become a member if he or she applies for a loan at a co-operative bank.

Figure 1 Member growth and member-population ratio



Source: Own calculations based on data from co-operative banking groups and statistical bureaus.

The decline in the number of local or regional co-operative banks due to mergers or governance changes slowed down from 5.3 per cent in 2017 to 3.4 in 2018. By the end of 2018, there were about 2,900 co-operative banks. In 2018, co-operative banks reduced their branch network by 3.1 per cent. Although this reduction is in line with the long-term trend, the pace of branch closures by co-operative banks in the past two years has been much higher than in many previous years. However, this sharp reduction is outstripped by the historically exceptional decline in the number of branches of other banks by 5.3 per cent. In 2018, headcount at co-operative banking groups contracted by 1.1 percent, while total bank employment dropped by 2.1 per cent.

Jump in market shares

As far as could be ascertained, co-operative banks attained the highest domestic market shares ever. The loan and deposit market share rose by no less than 0.5 percentage point (Table 1). This apparently moderate increase implies a marked relative shift of many billions of euros in loans and deposits. As other banks reduced their physical presence to a greater extent than co-operative banks, the branch market share of the latter surged sharply to 33.

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

	2011	2012	2013	2014	2015	2016	2017	2018	Change in percentage points (2011-2018)
Loans	21.2	21.5	21.8	21.9	22.1	22.4	22.6	23.1	+ 1.9
Deposits	20.9	21.3	21.5	21.4	21.4	21.8	21.5	22.0	+ 1.1
Branches	29.1	29.6	30.7	31.4	31.5	32.3	32.3	33.0	+ 3.9

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

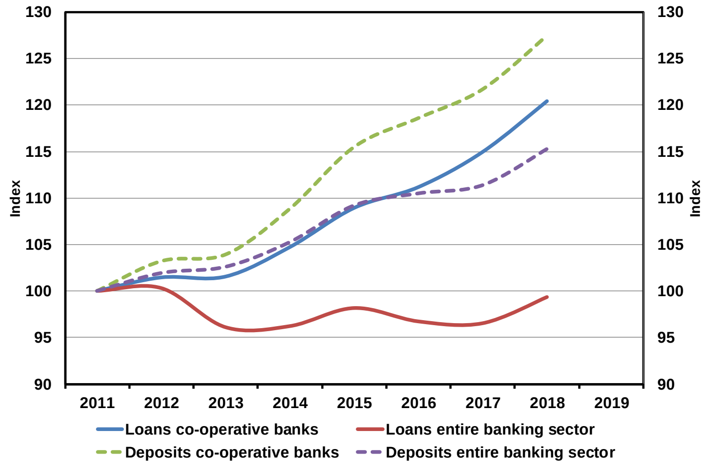
The branch market share has always surpassed the loan and deposit market share, but the difference has never been as pronounced as it is now. One could argue that a historical differentiator of cooperative banks is still visible: they operate with relatively dense branch networks and are physically close to their members. This fact does not mean that co-operative banks are not increasingly shifting from physical to virtual distribution channels for their products and services. Nevertheless, some recent studies point out that the combination of an accelerated shrinking of branch networks and the growing use of digital distribution channels for financial services may erode various distinguishing features of co-operative banks. On the other hand, it can be observed in practice that co-operative banks recognize this challenge. Therefore, these developments should not necessarily lead to fewer contacts with members (representatives) and less effective governance, provided that appropriate action is taken in good time.

Robust loan and deposit growth

The increase in market shares is obviously reflected in higher loan and deposit growth at co-operative banks compared to all other banks. Co-operative banks expanded their loan portfolio by 4.7 per cent, while the outstanding loan volume of other banks increased by 2.9 per cent. Both credit growth rates are the highest since 2010. Figure 2 reveals that the credit expansion of co-operative banks has always exceeded loan growth of all other banks. Since 2011, the former granted the non-financial private sector 20 per cent additional loans. After a period of contraction, the credit volume of other banks has returned to the same level as in 2011.

In 2018, co-operative banks also increased their deposit base by 4.7 per cent, whereas deposit growth at other banks (3.5 per cent) exceeded their loan expansion. The green and purple dotted lines in Figure 2 indicate that co-operative banks have attracted significantly more deposits each year than other banks.

Figure 2 Loan and deposit development (2011 = 100)



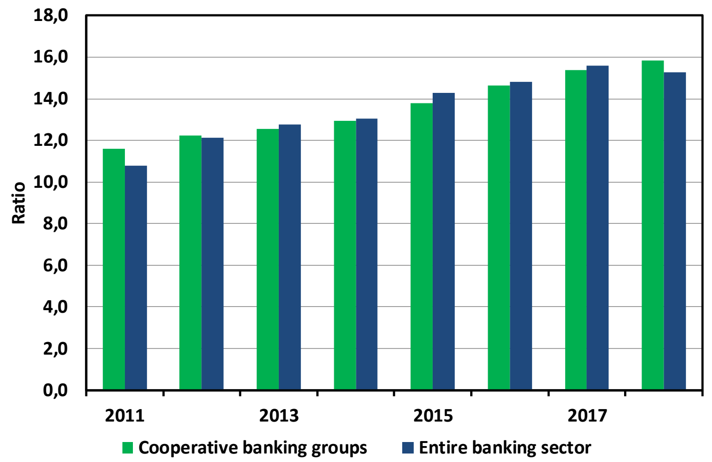
Source: Own calculations based on data from co-operative banking groups, national supervisory authorities and/or central banks. It concerns loans and advances to the non-financial private sector, excluding government.

The described loan and deposit developments resulted in a stabilization of the loan-to-deposit ratios just below 1 for both co-operative banks and all other banks in 2018. Just before the outbreak of the Financial Crisis in 2008, private savings covered around 80 percent of the private loan portfolio of the entire banking sector, whereas co-operative banks operated with a minor 'deposit gap' of 3 per cent. In a short time span, all other banks bridged their deposit gap by reducing short-term wholesale funding and restricting lending growth. They now make more use of stable deposit funding. This hints at a partial convergence of funding strategies of both types of banks, which may be partly enforced by new regulatory requirements in recent years.

Record level of Tier 1 ratio

Co-operative banks also hit a new record level regarding their average Tier 1 ratio ($T1_{COOP}$). In 2018, this ratio rose by 0.5 percentage point to 15.9. The Tier 1 ratio of all other banks ($T1_{EBS}$) fell by 0.3 percentage point to a still very comfortable level of 15.3. For the first time since 2012, $T1_{COOP}$ was slightly higher than $T1_{EBS}$. Over a somewhat longer time span, a significant improvement in the stability of many individual banks can be observed as a consequence of stricter regulatory requirements and a cyclical upturn in the economy.

Figure 3 Average Tier 1 ratios



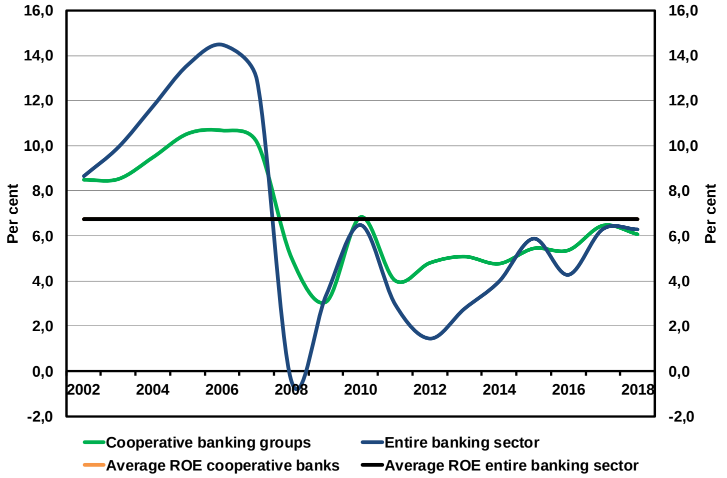
Source: Own calculations based on data from co-operative banking groups, national supervisory authorities and/or central banks.

Before, during and directly after the Great Financial Crisis, the discrepancy between both ratios was much larger as co-operative banks conducted their banking business with higher capital buffers. Since 2012, $T1_{COOP}$ is not significantly different from $T1_{EBS}$ (Figure 3).

Stable return on equity

In 2018, the returns on equity were almost identical to those in 2017. They also roughly equalled their long-term average over the period 2002-2018 (6.8%) as illustrated by the coinciding horizontal lines in Figure 4. This result is due to many interacting factors, among which continued moderate economic growth, the low interest rate environment, increasing regulatory costs. The actual pattern of both ROEs highlights a much lower volatility of co-operative banks' returns.

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

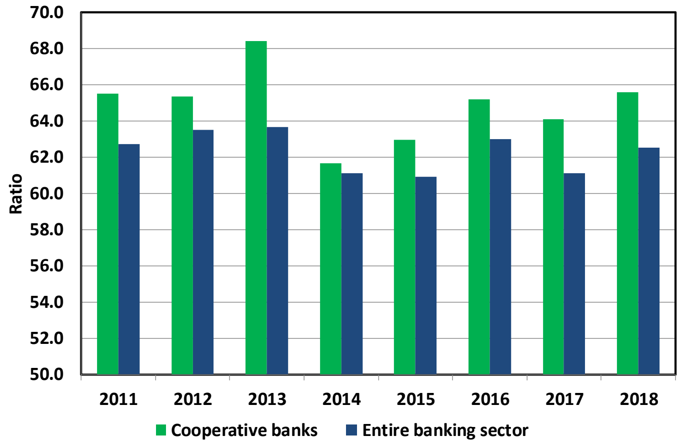


Source: Own calculations based on data from co-operative banking groups, national supervisory authorities, the ECB and World Bank.
Note: The orange and black lines represent the average return on equity of respectively co-operative banks and the entire banking sector over the time period 2002-2017.

Since co-operative banks are primarily focused on retail banking, it is actually surprising that they have been able to maintain their ROE in times of very loose monetary policy. Underlying data indeed show that they have been affected by the extremely low interest rates. Net interest income as a percentage of total assets has plummeted from 1.5 in 2011 to 1.2 in 2018. The negative impact of this drop was particularly offset by higher 'other operational income', and a significant fall in the cost of risk as a result of the economic upturn, which led to lower impaired loans. Co-operative banks have only reduced operating expenses to a limited extent. The component 'other administrative expenses' of the aggregated profit and loss account has even risen slightly. Although further research is needed, it is plausible that this is partly attributable to increased IT investments and higher regulatory and compliance costs.

Rising cost-income ratios

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



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

Underlying data indicate a slight fall in operational revenues and a modest increase in operational expenses, causing a rise in cost-income ratios by about 1.5 percentage points in 2018. Over the past eight years, the overall CI-ratio of co-operative banks has been somewhat higher than the average CI-ratio of other banks (Figure 5). The average difference amounted to 2.5 percentage points in this period. This persistent deviation can be ascribed to different factors. However, the conclusion that the co-operative structure in itself is associated with a higher cost burden would be inappropriate. For example, differences in business model, orientation, size, degree of internationalisation, etc. must be taken into account as well. Co-operative banks may also consider this ratio as a residual item. In that case, this indicator plays a limited role in their business decisions, as long as, for instance, customers are satisfied with the financial services offered and sufficient net surpluses are generated to solidify capital buffers.