Member-based enterprises:
The spotlight on financial services co-operatives

Inaugural address by
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Understanding Society

Prof. dr. Hans Groeneveld has been appointed as distinguished professor Cooperative Financial Services at Tilburg University, TIAS School for Business and Society, as of May the 1st, 2014. He studied quantitative macroeconomics at Erasmus University Rotterdam and holds a PhD in monetary economics at Maastricht University. His professional career started at the CPB Netherlands Bureau for Economic Policy Analysis in the section Labour Market and Social Security and Taxes. Thereafter, he worked for ten years at De Nederlandsche Bank in the monetary and supervisory directorate, respectively. Currently, he is senior vice president Co-operative and Governance affairs at Rabobank. In this capacity, he is involved in strategic and organizational projects and he maintains extensive networks in the national and international co-operative world, among other things. Before taking up this job, he held various senior and managerial positions in staff divisions and business directorates. He has been Senior Consultant Corporate Strategy, Deputy Chief Economist, Head Sector Management in SME banking, and Director 'International Services'.

To date, Hans is Board member of the International Raiffeisen Union in Germany, member of the Think Tank on European co-operative banks in Brussels, the Scientific Committee of the European Research Institute on Co-operative and Social Enterprises in Italy, and the Co-operative Business Education Consortium in Canada. He has published extensively on monetary topics, banking, co-operative banks and strategic and organizational issues in academic and policy journals.

Member-based enterprises: The spotlight on financial services co-operatives

Inaugural address

Given in shortened form at the public acceptance of the appointment of distinguished professor of Co-operative Financial Services at TIAS School for Business and Society at Tilburg University on Friday, 13 February 2015, by Prof. dr. Hans Groeneveld

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Introduction

Co-operative enterprises are economic democracy in action. Political democracy is almost universally valued in the Western world, but the idea of economic democracy has been largely ignored in favor of a model that concentrates on economic decision-making power in proportion to wealth in recent decades (Nadeau, 2012). The co-operative organizational form in general is also hardly taught at quite some universities and has not been given the proper exposure in academic publications, press and reports for many years (Kalmi, 2007). In this respect, I would like to share a striking anecdote with you. Over the years, I have been regularly asked by various Dutch universities to get third- or fourth-year students of law, business economics or administration encountered with the co-operative model. During our interactions, I learned that, as future employees, civil servants, policy makers and managers, these students had not read or heard about this model in their study career ever before. It is peculiar to have to explain the basic notions of co-operatives at such an advanced stage of academic education for the first time. The students needed to be brought in a completely different mindset to comprehend the matter. I must have confused and triggered these students, judging by the glassiness of their eyes as well as their eagerness to learn more about co-operatives afterwards.

I have also come across an incomprehensible sign of the neglect of all 'alternative banks', i.e. not-for-profit banks, in the literature. The widely used and highly esteemed *Oxford Handbook of Banking* (2014, second edition) consists of 1,104 pages. However, it appears that none of the forty chapters of this book deals explicitly or implicitly with the existence, specifics, and organizational model of not-for-profit financial intermediaries or stakeholder-oriented banks. In the Handbook's index, the term 'co-operative banks' was only referred twice, and the section of the book in which they are mentioned is also very surprising; in a chapter devoted to banking in Japan.

Hence, it seems helpful to first devote some words to the history, principles and features of co-operatives. Subsequently, facts and the latest research insights on co-operatives will be presented. Thereafter, financial services co-operatives will be the main focus. I will describe the different types of financial co-operatives and their current market positions. Co-operative banks will receive more attention, since they are significant players in the European banking sector. Finally, I will end this inaugural publication with concluding considerations.

Brief history and principles of co-operative enterprises

Though not very well-known, the co-operative model dates back to early civilizations in Egypt and China around 1,500-1,300 BC. Around 550 BC, agricultural products were exchanged and sold in co-operative models in Babylonia. These co-operatives also provided loans to the poor, particularly to offer an escape from exploitation by informal money lenders. The origin of the modern co-operative model lies in the United Kingdom and Germany in the first part of the 19th century. The emergence of consumer and producer co-operatives coincides with the Industrial Revolution and the depression in the agricultural sector. It would require far too many words to do justice to the history of co-operatives.[1] The short version is that co-operatives were initially inspired by socio-therapeutic, social-political or ethical/religious motives to rectify unfavorable market conditions and/or mitigate risks or market failures for their members. The underlying intention was to alleviate poverty, hunger and exploitation of small groups of people with common needs united by solidarity. It was about ensuring the economic independence of their members by means of promoting their economic interests, thereby combining individual self-interest and group interest. In other words, individual members could not overcome all kinds of issues or risks on their own, so they joined forces and set up collective enterprises.

In the co-operative history, the establishment of a consumer co-operative in 1844 by a number of textile workers in Rochdale, near Manchester in the United Kingdom, was an important milestone. These workers were exploited by their employers in various ways. Until then, they had to buy basic goods at extremely high prices at stores owned by employers. Their co-operatives charged regular store prices. They retained a part of the 'profit' inside the consumer co-operative and ensured that individual stores were run well. Their consumer co-operative proved to be quite successful as a business, and the concept was soon introduced elsewhere. The initiators were known as the 'Rochdale Society of Equitable Pioneers' and their business guidelines for good store management as the 'Rochdale Principles' for consumer co-operatives.

[1] Van Diepenbeek (2007) provides a fine historical overview of the different co-operative schools.

Figure 1 Rochdale Society of Equitable Pioneers

These principles were much later modified and made official by the International Co-operative Alliance (ICA). The seven ICA principles are: (1) Voluntary and open membership, (2) Democratic member control, (3) Member economic participation, (4) Autonomy and independence, (5) Education, training and information, (6) Cooperation among co-operatives, and (7) Concern for community. ICA defines a co-operative '*as an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly owned and democratically controlled enterprise*.' In addition, ICA states that co-operative enterprises are ideally based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity.

For modern financial co-operatives, developments in Germany in the 1850s deserve elaboration. During an agricultural depression at that time, a social reformer and local mayor, Friedrich Wilhelm Raiffeisen, provided emergency food aid to hungry farmers and their families, but soon realized that what they really needed was access to affordable financial services, such as credits. Based upon earlier experience, he became convinced that charity is not effective. His motto in German from the Bible was: '*Wer nicht arbeitet, soll auch nicht essen*' ('If a man will not work, he shall not eat').

Anyway, financial services were considered to be key for farmers to modernize their production methods and gain access to markets for their products. Both aspects improved the living conditions of the rural population considerably. In 1864, Raiffeisen established the first credit co-operative (later co-operative banks) and formulated his own set of principles (Raiffeisen, 1866):

1. Principle of solidarity: unlimited liability for all debts to be sustained by all members of the co-operative bank;
2. Sober management, no payments to directors, and minimum costs of business. The elected Board governs the co-operative bank for the noble cause of it, without any remuneration. The bank should be economical in all other respects and not incur any unnecessary costs;
3. Local character: working area of local banks is limited to the local community, village or parish. Local banks are affiliated with a regional or national secondary co-operative bank;
4. Full reservation of all profits: credit co-operatives did not aim at maximizing short term profits, but profits were necessary for further growth and were for the larger part retained and added to the capital base. They have to provide loans to members against normal market interest rates (i.e. "non-usurious" rates), fully reserve the realized annual surpluses, and do not re-distribute any surpluses to the members.
5. Appropriation of a responsible part of the surplus for social and charitable purposes, in order to improve local living conditions.

Figure 2 Raiffeisens's book

Die

Darlehnskassen-Vereine

als Mittel zur Abhilfe

der

Noth der ländlichen Bevölkerung,

sowie auch

der städtischen Handwerker und Arbeiter.

Praktische Anleitung

zur Bildung solcher Vereine, gestützt auf sechszehnjährige Erfahrung, als Gründer derselben,

von

F. W. Raiffeisen.

Neuwied, 1866.

(Uebersetzung vorbehalten.)

Raiffeisen attracted followers in the Netherlands and Belgium. The Dutch and Belgian movement was led by the Roman Catholic priests Gerlacus van den Elsen and Jacob Ferdinand Mellaerts, respectively. They all encouraged farmers to establish farmers unions and to set up agricultural co-operatives and co-operative banks. Particularly, they considered the establishment of co-operative banks essential, because rich and poor – in the respective guises of savers and borrowers – could co-operate with each other within such an organization. This way, social solidarity was put into practice. Note that it was considered crucial for the viability to have a mix of higher and lower-end membership segments to generate deposits that could be used to finance other members. At the same time, another German social reformer, Franz Hermann Schulze-Delitzsch, invented a similar type of co-operative bank for townspeople, providing credits to enable artisans and small business people to come through turbulent economic times and frequent depressions that accompanied the industrial revolution.

With some delay, the co-operative concept for financial services got firm ground as well in North America as well, particularly by the efforts of Alphonse Desjardins in Canada and Edward Filene in the USA, who fervently believed in the potential of the co-operative idea. This resulted in the emergence of the co-operative Desjardins bank in Canada and a national movement for the formation of US credit unions. All these historical 'champions' of co-operative banking movements deserve a place in the photo gallery below.

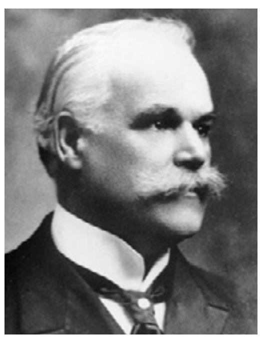
Figure 3 Historical champions of co-operative banking

Raiffeisen

Schulze-Delitzsch

Van der Elsen

Filene



Desjardins

Mellaerts

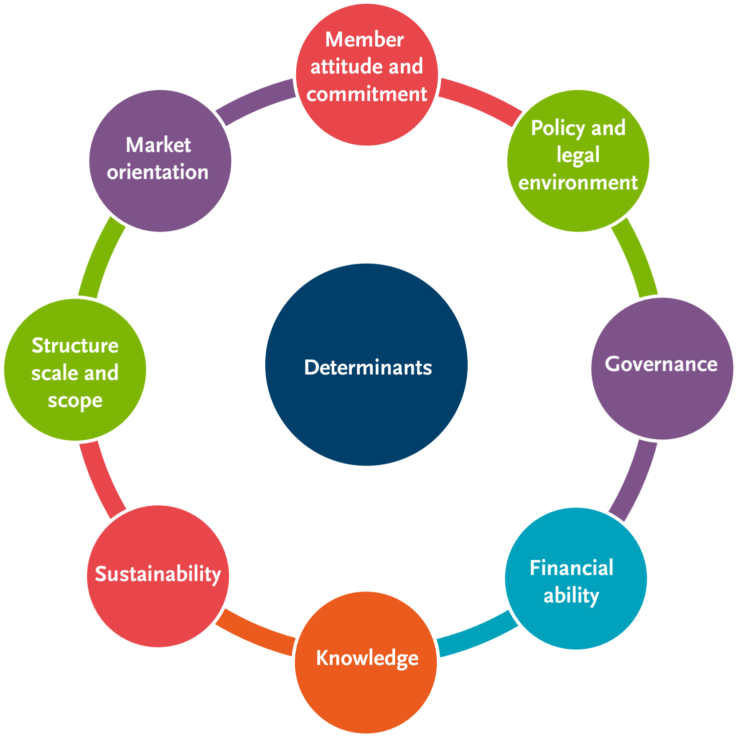
The founded co-operative banks and credit unions offered access to financial services, i.e. affordable loans, to formerly 'excluded' groups. Members provided funding or stood bail and were therefore involved in the decision-making and credit granting process. Knowledge of the credit-worthiness of one's neighbor meant that loans were safer. Unlimited liability implied that members had a keen interest in monitoring each other. The homogeneous membership base also meant peer pressure to repay. The feeling of communal solidarity reduced the potential conflicts of interest between borrower and saver, and between shareholder and management (Birchall, 2013).

Renewed appraisal of co-operative firms

The characterizations of co-operatives in terms of definition, principles and desired values underline the contrast between the primary motivating forces behind co-operatives and for-profit firms. Both kind of organizations participate in the market economy and need to be profitable to survive. But for genuine co-operatives, profitability is a means to safeguard continuity and growth on the one hand and to be able to meet social or societal goals ('*needs and aspirations*') on the other. For-profit firms are mainly what their name just indicates. The products and services they provide are a means to generate income for their investors, within the limits of the law and publicly acceptable standards for sustainability among other things, of course. This is quite the opposite of co-operatives' basic goal (Nadeau, 2012); co-operative firms are not subject to the pressure from investors for immediate returns, and can consequently apply a longer-term perspective.

Even when market conditions justify and may call for the establishment of co-operatives, they may not be established or viable due to various prohibiting and impeding factors. In short, an appropriate enabling environment for co-operatives should exist. In figure 4, I have distinguished eight factors that may hamper the establishment or endanger the viability of co-operatives. There are no clear borderlines between these factors, and each aspect influences the other. Co-operative enterprises can only survive or thrive if certain thresholds for each factor are simultaneously met. For instance, an enabling legislation is a key ingredient for a successful inception and/or healthy expansion of co-operative firms. Of course, market conditions in different countries and continents are not comparable and a wide variety of co-operatives around the world exists. Consequently, the importance and weight of each aspect vary across all kinds of co-operatives in individual countries and continents.

Figure 4 Key factors for successful and viable co-operatives



Source: Author

Co-operative enterprises established as socio-political or philanthropic rather than economic institutions are not viable. Purely social-political or socio-therapeutic goals are hardly found in the articles of association of co-operatives either. These articles generally refer to economic objectives for the benefit of each individual member. Various examples exist where co-operatives failed in the end, because they were used as instruments of ruling parties and the state to transform private ownership of means of production into collective (co-operative) ownership as a transitional stage towards state ownership. In these cases, the implicit motto was '*What we cannot nationalize, we co-operatize*'. Sometimes they were launched for the primary objective of being granted access to government support, yet without contributing to a lasting improvement of the employment and production potential of the members, to poverty reduction or to economic development. In many instances, they did not function as a business of their members or for their members and were not supported, funded and controlled by their members. These cases have given the word 'co-operative firms' a bad connotation in some countries.

Co-operatives need to comply with general market rules regarding innovativeness, making profits, realizing sufficient scale, having a market orientation, good governance and good capitalization policy. They need to offer quality services and products at fair prices. Otherwise, very few people will be inclined to become a customer first and subsequently take the step to become – or remain – a member. This does not mean that co-operatives cannot have favorable social effects. On the contrary, they can be very beneficial for certain groups in society, by removing or reducing hurdles for full economic and social participation and realizing economic advantages. Efficient co-operatives may also improve the terms of trade and the prosperity of people. However, social objectives and social effects are two different matters that must not be confused.

Modern co-operatives can be classified into five categories based on who the member-owners are (see table 1). For all of their differences and variations, successful, viable and sustainable co-operative enterprises share a single underlying characteristic: they evolved out of and provide effective solutions to the social and economic needs of their members. In addition, they are based on business or economic principles which are evidently different from those of existing business organizational forms in the markets, and particularly the profit-oriented enterprises.

Table 1 Classification of co-operative firms

Type	Description
Consumer co-operatives	Members are people who purchase goods or services through a co-operative.
Producer co-operatives	Members are farmers, artists, craftspeople, or other independent producers who join together or market their products cooperatively.
Employee-owned co-operatives	These co-operatives are owned by the people who work for the co-operative. The primary 'service' of this co-op to its members is their jobs and their role in steering the business.
Co-operatives of businesses and other organizations	Members are businesses, including co-ops, as well as other organizations such as nonprofits and governmental agencies. They can be both to sell and to purchase goods and services.
Multi-stakeholder co-operatives	These are owned and controlled by more than one type of member-owner. For instance, a purchasing co-op can have both individuals and organizations as members.

Source: Nadeau (2012, pp. 36-37)

The interest in the characteristics and business model of co-operatives has increased after the Great Recession that began in 2007. This turmoil has positively changed the opinions and views about co-operatives. Preliminary evidence indicated that the co-operative organizational form in general had performed significantly better than other organizational forms after the global financial crisis of 2007/8 and the following recessions (Davies, 2009; Birchall and Hammond Ketilson, 2009). Policy makers, regulators and academics started to wonder whether these achievements could indeed be related to asserted specifics of the co-operative model. The attention was further boosted by the United Nation's International Year of Cooperatives in 2012 (United Nations, 2011). In addition, international consultancy firms (Deloitte, 2012; McKinsey, 2012; Oliver Wyman, 2012) and The Economist (2010) started to pay attention to the merits and characteristics of the co-operative business model.

Global facts and figures on co-operatives

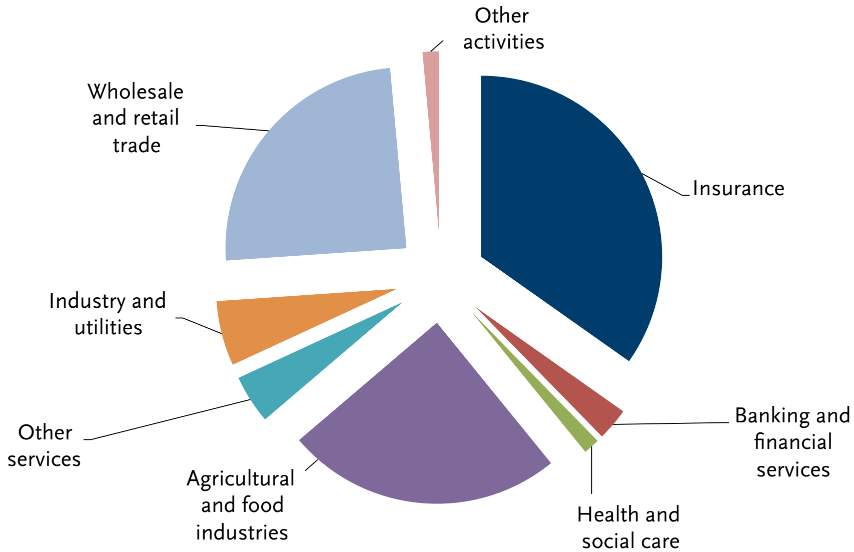
It has always been rather short-sighted to believe that the co-operative sector is marginal because their data are not so readily available compared to those of listed companies. Recently, a group of experts at Euricse in Italy and at the United Nations Department for Economic and Social Affairs have undertaken heroic attempts to set up databases for co-operatives on which to build. The collected data are first, but important steps to facilitate future research and disseminate objective facts about co-operatives. Anyway, these unique data rebut widespread misperceptions that co-operatives are small in size and number. On the contrary, there is a remarkable surge in new 'social' co-operatives in the areas of energy, health, care giving, education, employment and housing in recent years. This is partly due to the fact that many governments have to cut costs drastically, whereas the demand for social services will grow explosively in the coming years, also because of demographic developments (an ageing population). And the private market sector is not very eager to fill this gap.

Regarding size, the World Co-operative Monitor (2014) contains data of 1,313 co-operative firms across 50 countries with a turnover of more than US$ 100 million.[2] Figure 5 shows the distribution of the number of large co-operative firms over economic sectors. Among the large co-operative enterprises, mutual insurers are by far the largest category

[2] Size is proxied by turnover, which is defined as the income generated by the business activities conducted by a co-operative firm. For mutual and co-operative insurance organizations, the turnover is represented by their income of premiums. For co-operative banks, turnover is approximated by net interest income, i.e. the difference between interest income and interest expenses.

(27 percent), followed by large agriculture and food co-operatives (17 percent). Banking and financial services co-operatives represent 7 percent of the large co-operative enterprises.

Figure 5 Large co-operatives by sector of activity



Source: World Cooperative Monitor (2014), edited.

Note: the chart shows the sectoral breakdown of co-operatives with a turnover of more than 100 million USD in 2012.

This data refute the myth that co-operatives are small businesses and operate in the margins of the economy. They constitute important economic forces with market power. However, these large-scale co-operatives operate in an institutional business environment that is impregnated with neoliberal laws, procedures, practices and beliefs, and are under constant pressure to conform to this environment.

The first ever Global Census on Cooperatives (Grace, 2014) is a count of as many co-operatives, in as many countries as possible regardless of their sector or membership in regional/global associations. The Census is a compilation of the best available data on co-operatives and covers 145 countries with 2.6 million co-operatives. This large scale inventory reveals that over 1 billion people are members and clients of co-operatives. Additional calculations imply that one sixth of the world population has membership or is a client of a co-operative. A salient detail: there are more co-op memberships in the US (350 million) than there are people (320 million), i.e. US citizens are on average members of more than one co-operative. The Census estimates that all co-operatives around the world generated almost US$ 3 trillion in annual revenue during the most recent year for which data was available. The combined asset base of co-operatives amounted to about US$20 trillion. As a whole, the co-operative economy is larger than France's economy and ranks just behind Germany's economy as the 5th largest economic unit if it were a united country (Grace, 2014). Collectively, they employ 12.6 million persons in 770,000 co-operative offices, which equals 0.2 per cent of the world population. All these summary statistics on co-operatives are impressive, also because they can be considered as lower boundaries.

To assess the impact and size of the co-operative system in individual countries, three ratios have been utilized. First, the membership penetration of co-operatives relative to total population is computed. The second ratio is co-operative employment divided by total population. The third ratio mirrors annual gross revenue of all co-operatives in a country relative to the country's GDP. The ten highest rated countries for each of these measures are recorded in Table 2. The last column of this table reports a so-called Co-operative Economy Index, which is based on a weighted average of these three ratios. The latter index ranks the most co-operative economies globally. New Zealand has by far the highest Co-operative Economy Index, almost twice as high as France's ratio. In all categories, European countries dominate in the lists.

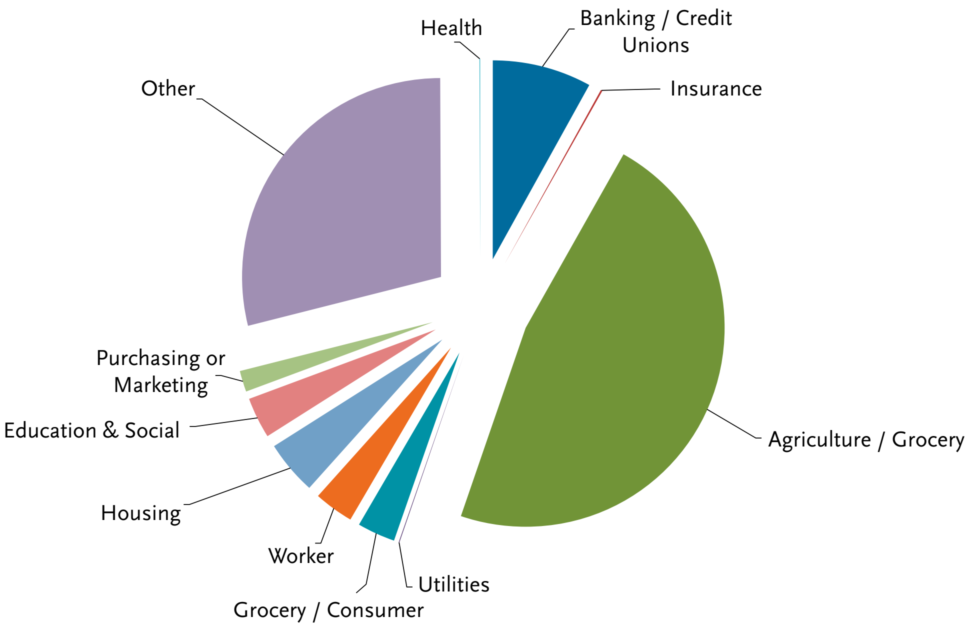
Table 2 Top ten co-operative countries and the Co-operative Economy Index

Rank	Membership & Clients/ Population		Employment/ Population		Annual Gross Revenue/GDP		Co-operative Economy Index
	Country	%	*Country*	%	*Country*	%	*Country*
1	France	225	New Zealand	9.7	New Zealand	20.1	New Zealand
2	Finland	138	Switzerland	2.1	Netherlands	18.0	France
3	Switzerland	130	Italy	2.0	France	17.8	Switzerland
4	Austria	95	France	1.7	Finland	13.8	Finland
5	Dominica	89	Malta	1.2	Luxembourg	9.6	Italy
6	Netherlands	80	Finland	1.2	Germany	9.4	Netherlands
7	Ireland	74	Germany	1.1	Ireland	8.1	Germany
8	Germany	64	Netherlands	0.9	Italy	7.8	Austria
9	Cyprus	62	Spain	0.9	Denmark	7.2	Denmark
10	Australia	60	Norway	0.8	Poland	5.8	Norway

Source: Global Census on Co-operatives 2014.
Note: The Co-operative Economy Index is an evenly weighted average of the membership to population ratio, the share of co-operative employment in total national employment and the co-operatives' gross revenues as a percentage of GDP.

Figure 6 shows the breakdown of all co-operatives across economic sectors. Most co-operatives are found in the agricultural sector, which is particularly influenced by large numbers of these co-operatives in India and China. The second largest category is 'Other', implying that quite some co-operatives could not be classified in a particular category. The third position is occupied by 'Banking/Credit Unions'.

Figure 6 Sectoral breakdown of 2.6 million co-operatives worldwide



Source: Global Census on Co-operatives (2014), edited.

Popular conception and reputation of the co-operative nature

A recent study has surveyed the general public's perception of co-operative organizations in ten countries on all five continents (Guy-Bernier Chair on Cooperation, 2014).[3] It explores to which extent the principles written down in the Statement on the Co-operative Identity (ICA, 2006) are valued by the population and contribute to differentiate co-operative organizations from their competitors. The selected individuals were first asked whether they were able

[3] The countries include Canada, United States, Brazil, Argentina, United Kingdom, France, Germany, South Korea, Japan and South Africa.

to identify businesses in four selected co-operative sectors, namely worker, producer, financial, and consumer co-operatives. The search for eligible respondents to complete the entire survey stopped when 400 persons in each country answered this question affirmatively. The researchers had to solicit around 18,000 people in all these ten countries to obtain 400 qualified respondents per country.

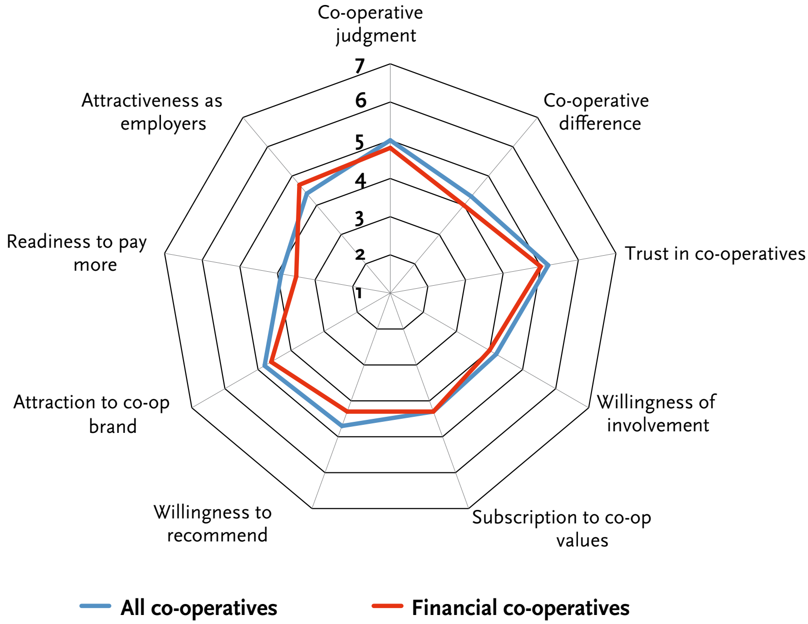
The qualified persons were requested to mark their opinion on two sets of statements. In the first set, they were asked to convey a co-operative judgment and to attach a figure to various attitudes towards co-operatives. The co-operative judgment indicates the level of achievement of the co-operative nature in the eyes of the interviewees. Regarding respondents' attitudes toward co-operatives, they were asked to give notes for the perceived co-operative difference, the trust in the co-operative, the willingness to be involved, the subscription to co-operative values, the willingness to recommend the co-operative, the attraction to the co-operative brand, the readiness to pay more, and the attractiveness of co-operatives as employers. In the second part of the questionnaire, respondents indicated to what extent they (dis)agree with statements related to seven frequently proclaimed manifestations by co-operatives which pertain to:

- four co-operative principles, i.e. openness to all (1st principle), democracy (2nd principle), possible distribution of surplus to members (3rd principle) and commitment in the community (7th principle);
- the core company mission or common need, i.e. taking into consideration consumers' interest by financial and consumer co-operatives, workers' interest by labor co-operatives, and producers' interest by producer co-operatives.

For all categories, the measurement scale runs from 1 (very bad/totally disagree) to 7 (very good/totally agree). A neutral result is equivalent to 4. The questionnaire finds that the quality of the image of co-operatives is on the positive side, judged by an average score of 4.8. The reputation is high on the aspects of social responsibility and prioritization of long-term rather than short-term gain. The image is less positive regarding the ability to innovate and the competitive advantage of offers.

Figure 7 is a 'spider gram' displaying the survey results for the complete sample worldwide and financial co-operatives across different dimensions. Respondents agree with the statement that all co-operatives and financial co-operatives comply with their co-operative nature; the score for co-operative judgment is 5.0 and 4.7, respectively. From linear regressions, it appears that three types of manifestations are likely to promote co-operative judgment for all co-operatives, i.e. those linked to openness, commitment in the community, and democratic practices. The influence of the manifestations on co-operative judgment is somewhat different for financial co-operatives. A more noticeable distribution of surplus to members would have a greater positive impact on the co-operative judgment score of respondents.

Figure 7 The respondents' co-operative judgment and attitudes towards co-operatives



Source: Guy-Bernier Chair on Cooperation (2014), reordered and edited.
Note: data collection took place at the end of spring 2014. The average values include the marks for the respective performance indicator of all qualified respondents. The figure '4' represents a neutral opinion. Marks below '4' indicate that respondents generally disagree with the proposition. A score above '4' denotes that respondents largely agree with the postulation.

The majority of respondents does not have a clear opinion about whether – financial – co-operatives differ from firms with other organizational forms; the average score is 4. For all co-operatives, the perception of the co-operative differentiation will be greatly fostered by clear manifestations connected with commitment in the community. Manifestations linked to democratic practices have considerably less impact. Respondents significantly agree with the statement that co-operatives are trusted companies; this aspect gets the highest score of 5.2 for all co-operatives and 5.0 for financial co-operatives. Confidence could be substantially improved further if people perceive that consumers' interests are taken into consideration. This holds particularly true for financial co-operatives.

The desire to participate actively in co-operatives is rather lukewarm. For financial co-operatives, this willingness can be increased remarkably by a distribution of surplus. Interviewees' subscription to co-operative values is modest for all types of co-operatives, including financial co-operatives. Furthermore, respondents are moderately willing to plea in favor of co-operatives and are also moderately attracted to the co-operative brand. Both attitudes could be boosted considerably by an active presence in the community development, and by paying attention to consumers' interests. Commitment in community seems extremely important for financial co-operatives with respect to people's willingness to recommend and their attraction to the co-operative brand.

Interviewed people are not prepared to pay more to do business with a co-operative. This holds in particular for financial co-operatives that have the lowest score on this aspect (3.5). This confirms my opinion that co-operative enterprises should just deliver good products and services at fair prices, i.e. they have to operate efficiently in any case. Finally, the attraction as employers is qualified as reasonable for all co-operatives and as moderately positive for financial co-operatives. For financial co-operatives, this opinion is rather sensitive to the way they express that workers' interests are taken into consideration.

Financial services co-operatives

Let me now turn to the focus institutions of my chair at TIAS School for Business and Society: financial co-operatives. I define financial co-operatives as member-based organizations in the financial sector with a non-profit-maximizing objective. Member representation is the hallmark of a financial co-operative and indispensable for the realization of the overall mission of the organization. All financial co-operatives tend to work 'bottom-up', with some form of member representation, e.g. board members selected through local elections or regional councils in local and/or central governance bodies. This sharply contrasts with shareholder value financial institutions which tend to have a single, centralized board that operates top-down through an appointed CEO with wide latitude to define the company's operating strategy, policies and structures from the centre (Oliver Wyman, 2014).

The industry panorama of financial co-operatives is both varied and dynamic. It basically comprises Building Societies, mutual insurers, credit unions, co-operative banks, and banks set up by other co-operatives. Over time, most of them restructured and some developed into (inter)national network organizations. Most adaptations were prompted by the necessary realization of economies of scale and higher efficiency levels to stay innovative and competitive, and/or changes in the supervisory or regulatory environment.

Building Societies

The first Building Societies were established in the United Kingdom in the 1770s, well before credit unions and co-operative banks. They are owned by their saving and borrowing members. Originally, Building Societies were not banks. They were financial institutions of another, specialized kind. They were a mix between a savings bank and a co-operative mortgage lender. The underlying principle was simple, and stood at the core of their business model ever since: every member would pay a monthly subscription to the society. The acquired funds were used to grant loans to members wishing to acquire property, which was the collateral to the loans (Butzbach, 2014). It is only belatedly (in the third quarter of the twentieth century) that they were allowed to expand beyond mortgage lending and become more bank-like.

The number of Building Societies peaked at 2,800 around the 1890s, and then declined due to an aggregation process. Meanwhile, the number of members kept increasing to 43 million members in 1988; this was more than two-thirds of the British population. They had a near monopoly position on the mortgage credit market. Then, a steep decline followed, partly as a result of liberalization with banks entering the mortgage market. To date, the 45 Building Societies hold around 20% of the total outstanding residential mortgages as well as total retail deposits in the UK. They have to be at least for 50 percent funded from their 19 million members. In effect, they are for a maximum of 50 percent wholesale funded. Lending on residential property should at least account for 75 percent of total lending.

Unlike co-operative banks in continental Europe, Building Societies have the ability to convert to a public limited company (plc), or other mutual, status with members' approval. Members of a building society have an ownership claim on the reserves of a society which, providing sufficient votes are secured, can be liquidated for personal gain on a conversion to a plc status. This feature triggered a wave of demutualization in the 1990s with members' consent (Llewellyn, 2012). The issue is that the current cohort of members was able to appropriate mutual's intergenerational endowment in the event of demutualization. In effect, current members were 'compensated' for surrendering the benefits of mutuality. Eleven Building Societies, including the largest (Halifax), converted from mutual to shareholder ownership. Together, they accounted for 75 percent of the combined assets of all Building Societies. The conversion of many of the Building Societies has been a catastrophe. The main goal of the respective top management became expansion: increasing the size of operations, entering new markets and competing with large banks. These 'wannabe banks' (Butzbach, 2014) adopted riskier business models and faced severe losses in the latest financial crises. Not one building society that converted has remained an independent entity. They have either been taken over, gone bust or have been taken into state ownership. Table 3 details this tragic history.

Table 3 Demutualization of Building Societies and developments since

Building Society	Demutualization	Current status
Abbey National	1989	Taken over in 2004
Cheltenham & Gloucester	1995	Taken over in 1995
National & Provincial	1996	Taken over in 1996
Alliance & Leicester	1997	Taken over in 2008
Halifax	1997	Taken over, part nationalized in 2008
Northern Rock	1997	Nationalized in 2008 and sold in 2011
Bristol & West	1997	Taken over in 1997
Woolwich	1997	Taken over in 1997
Birmingham Mid.	1998	Taken over in 1999
Bradford & Bingley	2000	Taken over, part nationalized in 2008

Source: Gall (2012).

Those that remained mutual have continued more or less successful, with the weaker ones taken over successfully and the biggest, the Nationwide, coming through the downturn in good shape. In 2007-2008, these Societies benefited from a flight to safety among British depositors. They also maintained lending levels at that time, when many banks were deleveraging and shrinking their balance sheets. This is in fact counter-cyclical behavior. All these Building Societies received little direct support from the government in the financial crisis. Some hoped that the government would consider returning Northern Rock bank to the mutual sector. However, in November 2011, Northern Rock was sold to Virgin Money, disappointing those that wanted Northern Rock to be remutualized to restore some of the loss of diversity in UK banking.

Mutual insurers

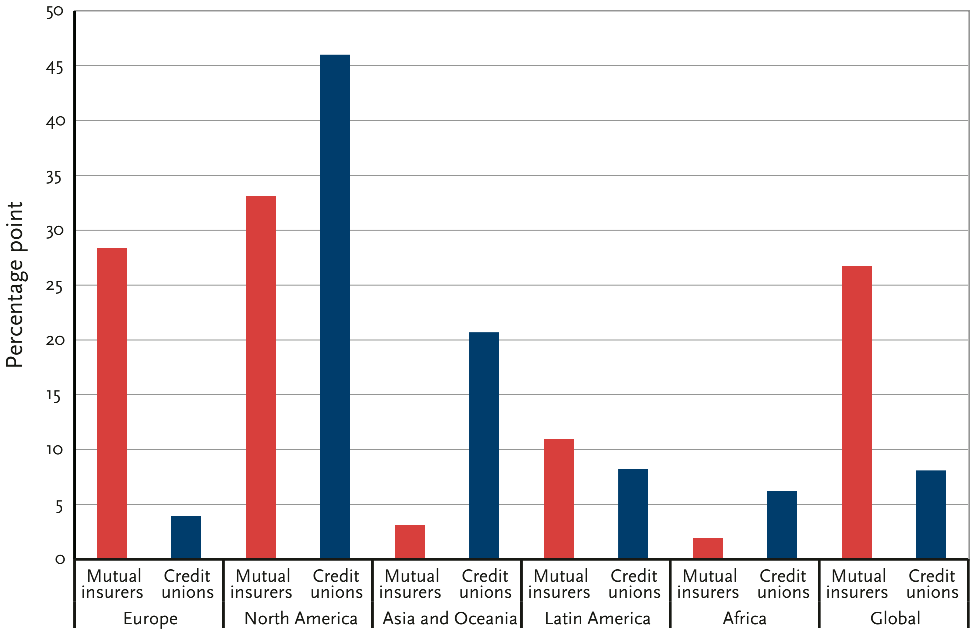
Mutual insurance is an old kind of co-operative business. It developed in the early years of the Industrial Revolution both in Europe and in the United States to pool the risks against the ever-present danger of fires in cities mostly built of wood. The extension of mutual protection or solidarity to health, life, automobiles and disasters later on also made sense (Nadeau, 2012). All types of insurances remove some of the uncertainty from everyday life for individuals and businesses, which a single person obviously cannot mitigate by him- or herself.

Membership in a mutual insurance company is different from that of other financial co-operatives. Instead of buying a share or voting stock, paying a member fee, or member liability, one becomes a member-owner of a mutual insurer by becoming a policyholder, but does not automatically have voting rights. Members of mutual insurers do not have a separate share in the capital of the company like members of co-operative banks or credit unions. Another characteristic of many mutual is 'proxy voting', in which policyholders can opt for having the board of directors cast votes on their behalf. In practice, this usually means that these boards have more decision-making power than the boards of most other financial co-operatives. It is fair to assume that many mutual insurance policyholders are actually not aware of the fact that they are members and as such own and, at least in theory, democratically control their insurance companies. This also has to do with the fact that many mutual insurance companies do not refer to themselves as co-operatives and have turned into hybrid organizations consisting of listed subsidiary insurance companies.

Mutual insurers employ around 1.1 million people and serve around 800 million policyholders/members. They have recorded consistently strong financial results since the crisis, and mutual growth has outperformed the total market in four of the previous five years (ICMIF, 2014). As a result, the global market share of the mutual sector in terms of premiums grew from around 23% in 2007 to about 27% in 2012. Interestingly, the three largest mutual insurers by premium income are Japanese. Four US mutual insurance companies parade in the top ten list. The Dutch Achmea Group occupies the 10^{th} position worldwide.

Figure 8 depicts the market shares of mutual insurers across 5 continents. In the USA, the largest insurance market in terms of both total and mutual premium income, the mutual sector's market share is the highest and amounts to about 35% in 2012. Mutual insurers also have a strong market position in Europe of close to 30%, whereas mutual insurers have small market shares Asia-Oceania and Africa. Looking at individual countries, the highest mutual market share is found in the Netherlands (53%), followed by Germany (43%), Japan (42%) and France (41%).

Figure 8 Mutual insurers' market shares and market penetration of Credit Unions



Source: International Co-operative and Mutual Insurance Federation and World Council of Credit Unions, edited.

Note: Market share of the mutual insurance sector is measured in terms of premiums in 2012. The penetration rate of credit unions (2013) is calculated by dividing the total number of reported credit union members by the economically active population age 15-64 years old.

Mutual insurers are confronted with major changes in the external environment. ICMIF states that economic and social shifts during the last decade have created a significantly different type of insurance consumer. The global financial crisis has led to falling incomes in real terms and a commercial slow-down in many markets. Consumers' price sensitivity has sharpened, while their service expectations continue to grow. Furthermore, the nature of member engagement, its economic and strategic rationale, and the challenges of implementing a member engagement program are clearly strategic issues for mutuals. Especially for smaller mutuals, technological advances and regulatory changes (Solvency II) are posing additional challenges.

Credit unions

Credit unions mostly operate under a lighter regulatory and supervisory regime than co-operative banks and only serve members. They are predominantly funded by retained earnings, member shares and voluntary member deposits and hardly rely on outside capital. The World Council of Credit Unions (WOCCU) states that their net income is applied to lower interest on loans, higher interest on savings or new product and service development. WOCCU has collected data on 57,000 in 103 countries, which serve around 208 million people. Credit unions possess USD$1.7 trillion in assets. Collectively, the credit union movement is smaller than the (European) co-operative banks. If we add up the totals for both, the credit unions have around 18 percent of total assets.

Box US Credit Unions and the Great Recession Schenk (2013) states that the credit union structural difference helped co-operative financial institutions come through the Recession nearly unscathed, while the US banking industry teetered on near-complete collapse. Because credit unions take on less risk, they tend to be less affected by the business cycle, and therefore can serve as an important counter cyclical economic force in local markets, softening the blow of economic downturns in local economics. Banking institutions significantly pulled back on lending in the wake of the recent recession in 2008-9. Credit unions filled the void and their loans grew by 8% during the height of the financial crisis, while bank loan portfolios declined by nearly 10% during the period. Similarly, credit unions have expanded their business lending in 2009-2013, while small business lending by other banks has declined in each of the past five years.

On a global scale, the penetration rate of credit unions is about 8% (see figure 8). The highest penetration rate is found in St. Vincent & the Grenadines (90%), followed by Barbados (78%) and Ireland (75%). The penetration rates are high in the USA and Canada (around 45%), yet they retain a small percentage of deposits. US credit unions have a deposit market share of almost 7% and around 100 million members. In Canada, credit unions have a deposit market share of 8% and more than 10 million members. The penetration rate in Latin America is more than 8%, but the deposit share level trail significantly around 3-4%. However, they are much more significant that these market shares suggest, because many credit unions reach down to some of the poorest people in each country and have a substantial economic impact.

The credit union industry structure and their issues vary tremendously across continents. Organized by size, Africa and Asia have the smallest credit unions, with respectively about 1,000 and 2,000 members. Latin America belongs to the middle category, with around 10,000 members. The most developed region is North America with 13,000 members per union. Europe is some kind of an anomaly with only 3,500 members per credit union, largely because much of the development in Eastern and Central Europe is recent (Birchall, 2013). Regarding diverging issues, an aging member base in Canada and the USA tends to be associated with the risk of excessive capitalization, as credit needs are concentrated in a younger demographic. For developing countries with less stable economies and more youth oriented work forces, credit needs continue later into life, and a lack of young workers affects the deposit base, risking the possibility of insufficient funds to meet seniors' lending requirements (Oliver Wyman, 2014). Many credit unions also operate in a fragmented market, though a great amount of consolidation has already taken place in many countries. For instance, the number of US credit unions peaked at about 24,000 in 1969, but now amount to less than 7,000. In some countries, credit unions have also formed regional/national corporate credit unions. They provide short-term and long-term investments or wholesale banking services for their member credit unions.

The activities of credit unions are sometimes constraint by laws; for instance, the small business lending of US credit unions is restricted to 12.25% of their assets. The operations of credit unions are also generally bounded to certain geographical areas, i.e. they usually cannot expand beyond predefined borders. In some countries, credit unions are exempted from taxes as a result of their not-for-profit co-operative structure. Furthermore, credit unions exhibit a range of maturity and sophistication levels across countries. Credit unions in Latin America tend, for example, to be smaller and even more locally oriented than in North America. They also place a greater emphasis on their social mission and have been really instrumental in expanding available access to previously unbanked or under-banked populations (Oliver Wyman, 2014).

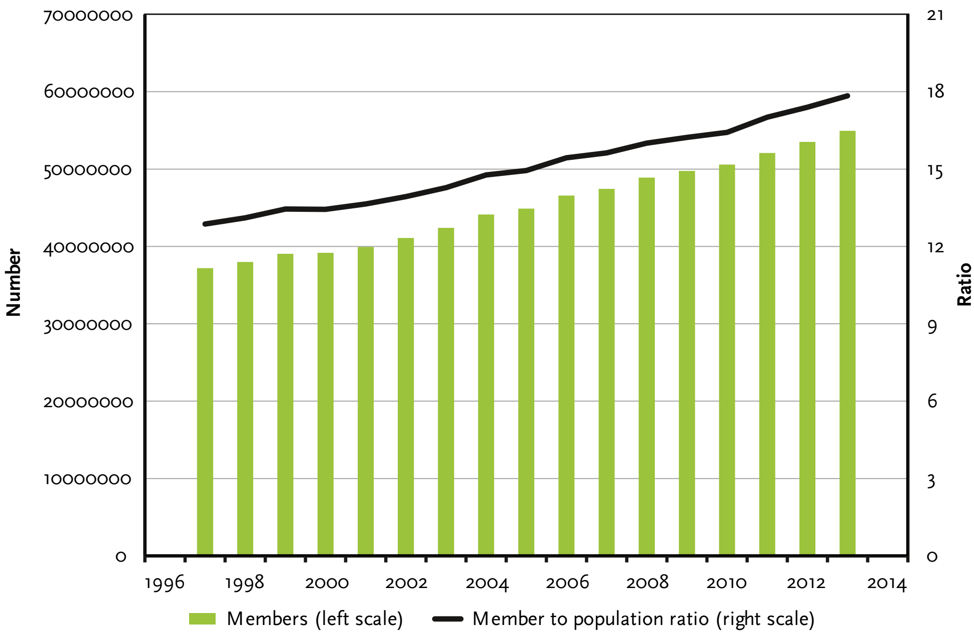
Co-operative banks

Since I fulfill my professorship in Europe, I'll pay more attention to the family of European co-operative banks as a whole. They have long been an integral and well-established part of the European financial system. Co-operative banks are an important part of the diversity and plurality in European banking and have their own characteristic business models, ownership and governance structures. The European co-operative banking sector can, therefore, be characterized as '*Commonality with Diversity*'. Co-operative banks operate with a full banking license and often also serve non-members nowadays.

It is commonly acknowledged that members and their elected representatives are an essential asset and actually embody the legitimacy for co-operative banks (EACB, 2007). Unlike members of Building Societies, members of co-operative banks cannot take away the capital, because it is 'capital in dead hands'. In the early days, membership was compulsory in order to be eligible for obtaining a loan from a local co-operative bank.

Many co-operative banks abolished this requirement a long time ago, implying that the development of the number of members can be interpreted as an implicit indication for the attractiveness and popularity of co-operative banks.

Figure 9 Number of members and member to population ratio



Source: Own calculations based on data from co-operative banking groups and national demographic statistics.

Figure 9 shows the number of members and the average member-population ratio for fourteen co-operative banks in ten European countries.[4] Strikingly, the number of members has increased continuously. Member growth does not appear to differ significantly between years of strong economic growth and financial stability and between years of economic slack and financial instability. The total number of members rose from around 37 million in 1997 to approximately 55 million in 2013, which equals a growth of almost 50 percent. On average, the member base grew at an annual growth rate of 2.5

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

per cent since 1997. In the last two years of the sample, European co-operative banks welcomed almost three million new members. In relative terms, the average member to population ratio showed an upward trend; the ratio rose from 12.9 in 1997 to 17.8 in 2013. The increase signals trust and confidence of customers in co-operative banks. Indeed, clients are presumably not very eager to become a member of local co-operative banks if the level of trust and satisfaction would be low.

The increase in the number of members has translated into rising market shares in national retail banking markets. Since 1997, co-operative banks succeeded to increase their domestic market shares in retail loans as well as in retail savings steadily and continuously. On average, both retail market shares rose by about 10 percentage points to more 26 percent in 2013. In the turbulent years 2007-13, co-operative banks also yearly strengthened their domestic market positions. These rises imply shifts of many billions of euros in loans and deposits towards co-operative banks. Like the substantial increase in the number of members, rising market shares can be interpreted as signs that customers feel attracted to co-operative banks for a myriad of different reasons.

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

As documented in quite some studies and reports, co-operative banks showed a remarkable resistance and resilience, and hardly needed state support in the time period 2007-2010 (Groeneveld and De Vries, 2009; EACB, 2010).[5] Many analysts and academics have attributed this achievement to the implications of their specific business model (see Ayadi *et al.*, 2010), which is measurably focused on the real economy. But these studies date back from a few years ago. Although the pressure from the initial financial crisis beginning in the summer of 2007 has clearly abated, the last few years remained tumultuous in economic and financial terms due to subsequent turbulent economic and

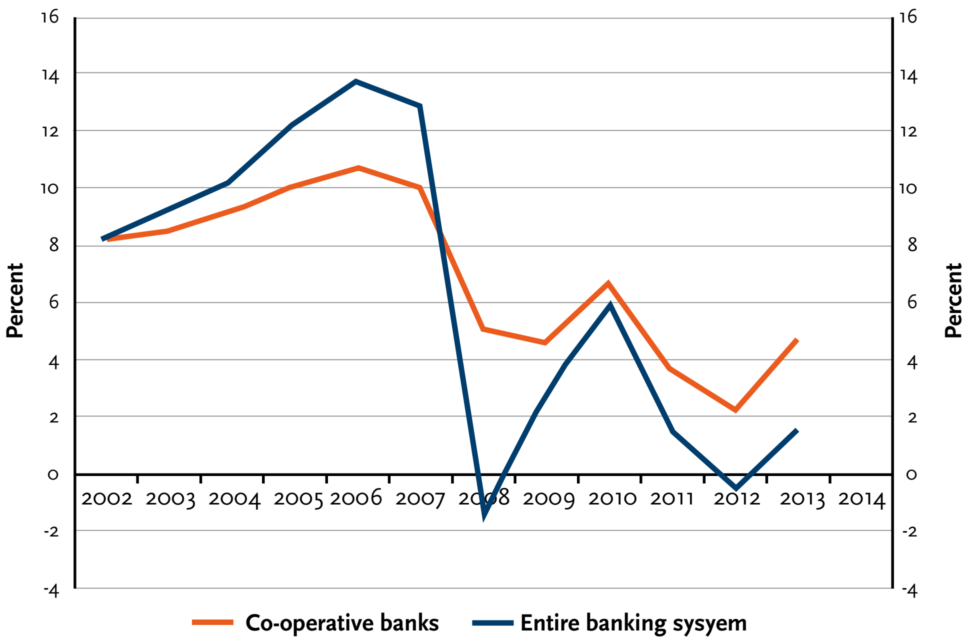
[5] Mooij and Boonstra (2012) feature a collection of case studies of co-operative banking groups in different times of crisis.

financial events in Europe. It is certain that many members and customers of co-operative banks were confronted with heavy headwinds. Indeed, co-operative banks were not immune to economic and financial shocks. In 2013, their total assets and loan portfolio actually shrunk by almost 3.0 percent and a very limited 0.2 percent, respectively. However, this decline is very modest compared to the contraction of total assets and loans at all other banks of almost 10 and 5 percent, respectively. Like loan growth, deposit growth at co-operative banks exceeded deposit growth at all other banks in 2012 and 2013, but their deposit expansion did decelerate.

An analysis of the balance sheet composition of co-operative banks and all other banks reveals two remarkable aspects. The assets of co-operative banks are dominated by loans to the non-financial private sector (with a loan to total asset ratio of more than 50 percent). The same ratio for all other banks amounts to 37 percent. On the liability side, a similar feature is visible. Overall, co-operative banks are funded to a larger extent by retail deposits and to a lesser extent by wholesale funding in comparison with all other banks. Note that the overall stability of the financial sector depends partly on the funding models used by financial institutions. The data thus suggest that the funding resilience of co-operative banks is relatively high. Moreover, the business model of co-operative banks tends to be more geared towards retail banking activities. Over a longer period of time (1997-2013), I found that loan and deposit growth at co-operative banks is also significantly more stable than that of all other banks (Groeneveld, 2014). In good times, co-operative banks' credit growth is more moderate, whereas their credit expansion is higher in recessionary times. Their behaviour seems thus to be counter-cyclical, like that of Building Societies and credit unions, which brings benefits to the wider economy.

A measure for the efficiency, the cost-to-income ratio, reveals that co-operative banks are on average as (in)efficient as all other banks over the past decades. This is untrue for their average return on equity, which is a widely used proxy for profitability (see figure 10). The average return on equity was higher before the Great Recession in entire banking systems. But that changed afterwards. In 2008 and 2012, the average return on equity of entire banking systems was actually negative, while co-operative banks on average still booked positive returns on their equity. In 2013, the return on equity of co-operative banks was twice as high as that of entire banking systems. These differences in recent years can plausibly be explained by the fact that co-operative banks were on average less involved in restructurings and non-retail banking activities, which have on balance dropped in volumes and revenues. Moreover, I also find that the average return on equity of co-operative banks generally exhibits a less volatile pattern than the return on equity of the entire banking sector. Their focus on retail activities apparently leads to more stable income streams.

Figure 10 Average return on equity



Source: Own calculations based on data from co-operative banks, European Central Bank and Swiss National Bank.

Finally, I would like to illustrate the relative stability of co-operative banks in the past decade by using the so-called *Z-score*.[6] A higher *Z-score* implies a lower probability of insolvency. Figure 11 shows that the average *Z-score* for co-operative banks has always been higher than that of total banking sectors. Co-operative banks are thus generally a more stable and safer part of the entire banking industry. They usually operate with higher capital levels and their returns on assets and equity are on average less volatile. This finding is in line with scarce earlier studies (Ǒhák and Hesse, 2007).

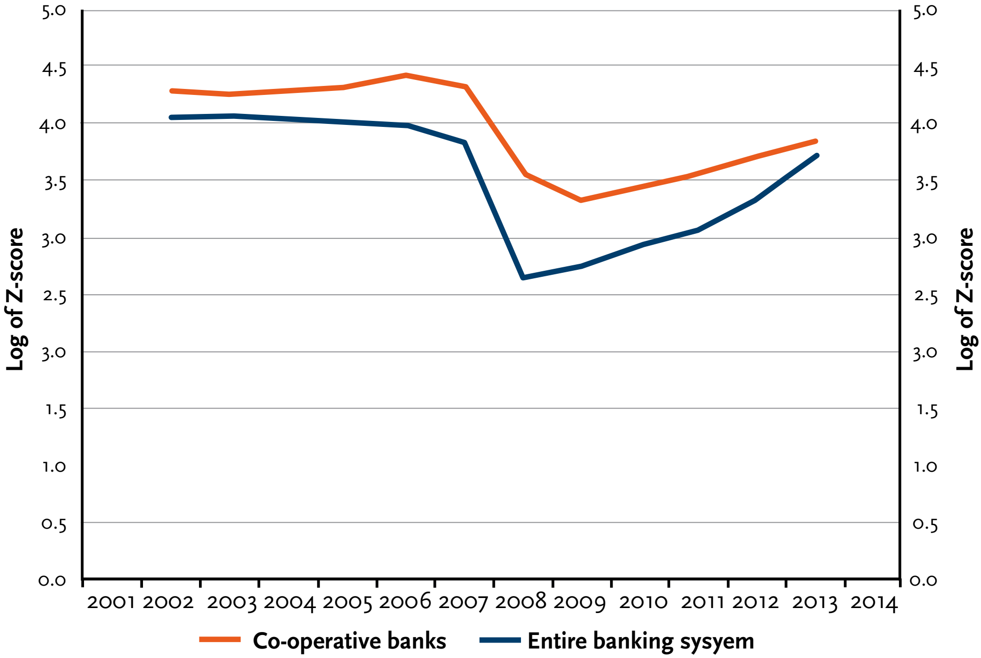
Incontestably, the stability of co-operative banks was negatively impacted by the financial turbulences after 2007, but entire banking systems were much more fragile with a *Z-score*

[6] The *Z-score* is a widely used measure of bank's distance to default (Mercieca *et al.*, 2007) that is monotonically associated with the bank's probability of failure (thus bank risk is defined as the inverse of the *Z-score*). This variable is defined as: $Z\text{-}score_i = (ROA_i + E_i/A_i) / \sigma(ROA_i)$. ROA is the Return on Assets, E/A stands for equity capital over total assets, Č (ROA) is the standard deviation (volatility) of ROA calculated as a four-year rolling time window, and i denotes a co-operative bank or an entire banking system. I use the natural logarithm of the *Z-score*, because this variable is highly skewed.

of around 2.5 in 2008/9. During these years, quite some investor-owned banks had to be supported with state aid or were nationalized to maintain financial stability and confidence among the public (CEPS, 2010). Note that co-operative banks reached the lowest *Z-score* in 2009, when entire banking systems were already regaining stability. This underlines that co-operative banks were affected differently by these shocks. After 2009, the entire banking system showed a gradual recovery. The volatility of the results dropped and the equity to asset ratio improved, partly imposed by national governments and/or regulators. In the last few years, the *Z-score* of co-operative banks did not improve as much as that of the entire banking sector and both *Z-scores* are now about the same. Quite some co-operative banks felt the consequences of persistent weak economic conditions, reflected in jumps in unemployment and failures in the SME sector. Some co-operative banks also incurred sizeable losses and write downs in areas outside the traditional co-operative core in recent years.[7]

[7] For instance, the Co-operative Bank in the UK faced serious financial problems after mismanagement stemming from megalomania and governance malfunctioning. It moved from the customer-owned sector to the shareholder-owned sector in 2013 and failed the UK banking stress tests in December 2014. The international subsidiary of Austrian Volksbanken (Volksbanken International) under the umbrella of the central institution (ÖVAG) needed state support as well a capital injection by the local Volksbanken in 2010. One of the attached conditions was that Volksbanken had to expropriate the major part of its international activities. In 2014, ÖVAG failed the stress test by the ECB and the Volksbanken decided to resolve ÖVAG, i.e. it will turn in its banking license. In 2013, Rabobank agreed on financial settlements with public authorities in various countries in connection with the Libor affair.

Figure 11 Average stability of co-operative banks and entire banking systems (Z-score)



Source: Own calculations based on data of co-operative banks, national supervisory authorities and ECB.
Note: The line for co-operative banks represents the average *Z-score* (in logarithm) for fourteen European co-operative banks in ten European countries (see footnote 4). The data for the entire banking sector represent the average *Z-score* (in natural logarithm) in these ten European countries.

Governance of co-operative banks

The governance models of co-operative banks are fairly diverse, yet contain a common set of operating principles. The main observable differentiator of co-operative banks is their specific corporate governance with some degree of member influence and control. In theory, members of a co-operative bank have significance not only by virtue of being customers or owners but also because they are an integral part of the governance structure (Groeneveld and Llewellyn, 2012). Governance arrangements are based predominantly on the principle of 'one member, one vote'. Decision-making is the result of dynamic interactions between organizational levels, managerial and policy structures and with members/customers. It is becoming increasingly crucial to demonstrate and explain how this process works for enhancing transparency towards regulators and building confidence among customers and members.

Co-operative banks are functioning with a representative democracy. Local members elect Board members, or in some instances called local supervisors, who monitor and control local/regional co-operative banks. Almost every local or regional bank operates with a local board consisting of elected board members and at least one professional banker (e.g. general manager of the local bank).[8] Representatives of these elected Board members play a formal role in central governance bodies, thus influencing the policy and strategic course of the entire organization. The rights, obligations and responsibilities of – representatives of – members in local and/or central governance bodies are laid down in internal statutes, articles of association, or by-laws. Member influence and authority surely cannot rule out policy and strategic mistakes, but can basically bridge the distance between executives and policy makers and the most important stakeholder, the customer. Many regulatory and supervisory changes will significantly impact certain fundamental principles of co-operative functioning, including their structures (Deville and Lamarque, 2014).[9] First, regulations are pushing for the centralization and unification of small co-operative structures and standardization of practices such as credit risk scoring. These developments are likely to leave local and regional entities feeling less autonomous, which not only undermines the *4th co-operative principle of autonomy and independence* but could also lead to disproportional rises in compliance of regulation for smaller co-operative banks in particular (Ferri and Pesce, 2011). Second, the European Commission's Capital Requirement Directive IV lists requirements for the role of governance bodies. In many countries, the level of professionalization and sophistication of elected board members has increased or has to increase considerably. Board members need to be able to challenge professional managers on their strategic decisions, matters of compensation, and risk policy. Elected board members cannot be 'docile' and must intrude on management decisions. Many co-operative banks are currently designing or already implemented permanent education programs to improve the competences of governance authorities.

For some local co-operative banks, some new requirements pose a challenge to find competent board members from their member base. Furthermore, stricter requirements from the supervisors with respect to diversity and independence of elected board members apply, i.e. so-called fit and proper tests. Strict application of the condition of independence could actually jeopardize the essence of local co-operative banks, where disciplinary forces can only come from elected and engaged members (since they do not have shareholders). A fully independent board member is

[8] According to my knowledge, Rabobank is the exception. At the local level, an elected supervisory board exists next to a professional board of directors.

[9] The Annual Report 2013 of the European Association of Co-operative Banks provides an informative overview of the implications of eminent changes in supervisory and regulatory regimes for co-operative banks.

actually not very compatible with the logic of elected representation corroborating co-operative structures.

The functioning of the governance is influenced by internal institutional arrangements, the organizational and capital structure, size and composition of the entire co-operative banking group. Present co-operative banking groups differ regarding the degree of centralization and integration within the networks, the size and focus of international activities, dependency on wholesale funding, and the design of the co-operative governance with member authority. Some co-operative banks have sold a part of their business activities to investors or became partly listed, thus gradually transforming into a hybrid type of financial co-operative. This sometimes creates internal tensions and potential issues regarding the use of non-public information in policy and strategic discussions with – representatives of – members in local and central governance bodies. Moreover, external investors could start to influence the – growth – strategy of the co-operative organization since they require a certain yield on their investments.[10]

In most cases, governance reforms and pressures of competition have led to a centralization of strategic and operating functions and processes (Desrochers and Fisher, 2005). This resulted in multiple tier networks, which vary from loose associations like the Italian Popular banks to highly integrated groups like Rabobank and OP-Pohjola. The shared second-tier operations comprise wholesale divisions, provide economies of scale and reduce costs, while retaining local relational banking and institutional foundations in social and political networks. In addition, many second-tier network organizations are responsible for the execution of internal solvency and liquidity mechanisms, i.e. the function of bankers' bank, and/or internal deposit guarantee schemes to ensure the overall stability of the network. To perform these tasks adequately, the federal bodies are often granted supervisory powers that provide a common set of standards for local banks to adhere to. These monitoring devices usually exert a strong disciplinary influence on member banks (and their management), apart from the intrinsic peer pressure within the network.[11] So, central institutions are usually contributing to cutting down on risks and increasing the stability of the group. However, they also sometimes represented a risk themselves, because they diverged from the customer-ownership business model and pursued other objectives.

[10] To overcome this kind of governance issues, the Finnish OP-Pohjola bought back all listed shares of a subsidiary in May 2014 for € 3.4 billion. On its website, this step was motivated by saying that OP-Pohjola '*was born to be owned by customers*'.

[11] In Finland, The Netherlands and Portugal, the APEX institution is officially responsible for the delegated supervision over the legally independent local banks on behalf of the external banking supervisors.

Safeguarding the co-operative profile and concept

The literature on agricultural co-operative firms contains a warning regarding the evolution of co-operative banks (Nilsson *et al.*, 2012). It concerns the conceivable risk of a decline in 'social capital', i.e. the disappearance of tight (member) networks as a result of the transformation into large and complex – hybrid – organizations, virtualization and/or the achievement of its original goals. This decrease implies a deterioration of the democratic functioning of the co-operative, i.e. members become less involved, engaged and committed.

It is undeniable that a decline in 'social capital' has also occurred in the evolution process of local credit co-operatives into the present co-operative banking groups, though this topic has hardly been investigated upon until now. For instance, the traditional dependence on member networks for funding or financial securities has eroded, since most co-operative banking groups now access debt capital markets and, therefore, must satisfy rating agency requirements to secure funding on favourable terms. At the same time, members' potential losses are now limited due to institutional protection schemes, thus weakening their original incentives to monitor the entire co-operative organisation. In many instances, the third ICA principle of *member economic participation* has eroded or disappeared in some instances (e.g. at Rabobank).

Furthermore, autonomy and discretion of local member banks in managing their affairs have diminished due to the increased necessity for centralised business functions to deliver efficiency gains through economies of scale and scope: the 4th co-operative principle of *autonomy and independence* for local banks has faded. Furthermore, customer contacts have increasingly grown into a digital nature, making it more difficult to establish or maintain personalized customer relationships. Indeed, client contacts are incomparable with client relations. These factors could all lead to a loss of social capital, which might be exacerbated by the associated consolidation among local banks and closures of branches. As local banks and their working areas grew in size, social networks and social capital are theoretically more difficult to maintain. Finally, the growing complexity of financial services provision and the establishment of subsidiaries for international activities like corporate and investment banking required professionalization of management and the associated establishment of central institutions where decisions are increasingly taken. In some instances, the centrals strayed from the natural business model and begun to take large risks.

I fully acknowledge that many structural changes and adaptations in business models, activities and governance structures of co-operative banking groups were necessary to remain economically and financially viable for their members and customers. However, I do think that some steps have been taken without fully recognizing or overseeing their implications for the co-operative profile and concept. And there is hardly a way back. Hence, it is important that co-operative banks stay closely in line with or adhere more strongly to the governance principles of co-operatives (ICA, 2006). I am particularly referring to the crucial importance of (i) the principle of democratic member control and (ii) competent and credible board members. Regarding (i), the external orientation of a financial co-operative can only come from – representatives of – its members. Members must be able to ensure a solid co-operative profile and exert a disciplinary impact on professional bank managers and/or the executive board of the central institutions. It suffices if a fraction of members actively participates in the co-operative democracy. They should secure the distinctive orientation and represent many members. Second, great attention is needed for the selection and training of people for leadership positions (i.e. elected and professional board members) with regard to their knowledge of the way in which co-operative firms work as well as their awareness and genuine endorsement of the co-operative ethos. Particularly, on-boarding of new staff from adjacent career paths to the co-operative requires special attention. In this case, a two-track integration seems appropriate: one for the new executive or skilled professional joining the co-operative, and one for the co-operative management team responsible for his/her acculturation. Rapid assimilation of the co-operative values on the part of new hires is warranted to acquire and respect the co-operative orientation, but equally important, the ability of existing management and other employees to benefit from the outside perspectives and experience of these new colleagues.

Concluding remarks

Paradoxically, the Great Recession proved to be a kind of blessing in disguise for co-operative businesses. Their relatively good performance in 2007-2010 attracted much policy and academic interest. It is also recognized more and more that co-operative enterprises must be entrepreneurial, cost-effective, efficient, and professional organizations to be able to cope with competition. Otherwise, they will not able to deliver member value, to realize sufficient profits that ensure the continuity of their activities and to aim at social objectives in (local) societies. In effect, the dual bottom-line intention of co-operative enterprises matches exactly with the key objective of TIAS to be a '*School for Business and Society*'.

Turning to financial services co-operatives, it is undeniable that they were and are distinct players in the financial sector. Their business model is different and their overall performance has deviated from that of all other banks in different phases of the latest business cycles. They were affected by subsequent crises in recent years, but their stakeholder-oriented governance has always fostered a predominant orientation towards retail banking. This focus demonstrably results in a smoothing of the economic cycle, a moderate risk profile and close links with the real economy. These 'hard' facts underline the benefits of various competing models in financial services to the wider financial system and the wider economy. Diversity in ownership and business orientation leads to diversity in risk appetite, management, incentive structures, policies and practices as well as behaviours and outcomes. It offers greater choice for customers and society through enhanced competition that derives in part from the juxtaposition of different business models.

The external environment lately changed fundamentally for financial co-operatives lately. It concerns changing standards and values in society, technological developments, a negative image of banks, altering consumer behaviour, a more stringent supervisory and regulatory framework, higher capital and liquidity requirements, cybercrime and remaining latent risks in the real and financial economy. In Europe, a shift from national to European banking supervision and the formation of the European Banking Union took place.

Apart from these general challenges, other factors have modified the context as well as the relationship networks in which banking co-operatives operate. Competition has fiercely increased for the traditional core of co-operative banks' business as a result of a strategic reorientation towards retail banking of many other financial players and the emergence of new players in financial services (crowd funding, peer-to-peer lending lending), facilitated by IT innovations. At the same time, local identity could lose importance in firms' and families' financial decisions, in favour of straightforward interest rate or price considerations (Goglio and Alexopoulos, 2014). This trend is reinforced by increasing virtualization in banking, which puts their dense branch networks in another perspective and leads to closure of branches (or mergers between local co-operatives). By definition, the consolidation in networks increases – literally and figuratively – the distance between members and local financial co-operatives and reduces the number of elected members in formal governance bodies. This raises the question how to keep sufficient members involved and engaged in governance bodies.

Hence, co-operative banks have to find solutions for the following issues (i) the adherence to and expression of co-operative principles and values, (ii) members' participation in decision-making, (iii) reciprocal relationships with members/customers, (iv) solid commercial performance, (v) future capitalization and/or accessing new funding sources, and (vi) achievement of operational excellence and last but not least (vii) stricter regulatory and supervisory requirements. At the same time, they need to look for ways to continue operating in proximity to and as relational organizations for customers and members, thus enhancing social-economic relationships with their territories and a sustainable development of these areas (Guy-Bernier Chair on Cooperation, 2014). Aiming at social goals simply asks for physical presence and close relationships with local authorities and economic actors. In this respect, it seems important that the territories of local financial co-operatives largely coincide with the local areas with which members feel connected. Financial co-operatives should also investigate how to express their co-operative identity in knowledge based relationships with members and customers in virtual communities.

The co-operative business model is strong, but like any other business financial co-operatives can sometimes fail; there is no substitute for competent management and good governance. Indeed, how co-operative banks tackle all challenges is largely determined by the set-up and functioning of the representative democracy, i.e. how and to what extent members participate in strategy, control, supervision, policy and decision-making. Representatives of members and financial professionals are jointly responsible to find ways to reconcile the necessary transformation and adaptability of co-operative banks to structural and cyclical developments in society and banking, while preserving the core principles and the differentiating co-operative profile (see Fonteyne, 2007). Members need to dispose of 'handbrakes' to safeguard the co-operative identity and to tone down growth ambitions (of executives of central institutions) beyond the traditional scope of the co-operative business. The special features should be seen as competitive advantages, which should not be threatened by dilution of the co-operative concept. The co-operative does not just belong to the current cohort of members, but is an intergenerational endowment held in the business for the benefit of current and future members. The key issue is that without members there cannot be a financial co-operative, and a financial co-operative with voiceless members is not a co-operative either.

Ik heb gezegd.

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