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Snapshot of European Co-operative Banking 2017

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TILBURG UNIVERSITY
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Foreword from the EACB and TIAS

For the third year in a row, TIAS School for Business and Society releases an overview of the overall performance of European co-operative banks, with support from the European Association of Co-operative Banks (EACB) based in Brussels. Since 1970, the EACB represents, promotes and defends the common interests of its 28 member institutions.

The snapshot examines key indicators of co-operative banks in the context of rapidly changing and challenging external circumstances. The document also compares the performance of co-operative banks to that of all other banks in recent years. The report advocates the preservation of different ownership structures in the banking sector. Based on standard bank performance metrics, it can be objectively concluded that economic and financial developments impact differently on co-operative banks compared to banks with other organisational forms. In almost every single year, their average performance diverged from that of collective banking systems. We argue that these findings can be mainly ascribed to their member-based governance. If business models and orientations of banks vary, they are not hit in the same way and to the same extent by all types of distortions. From this reasoning, it follows that regulators should encourage diversity and promote banks oriented to support SMEs and households at the domestic level.

We sincerely hope that this report increases policy and academic awareness for the demonstrable link between organisational diversity on the one hand, and stability and competition in banking on the other. If policymakers recognise this fact, it would help them in weighing up the future shape of the banking sector.

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EUROPEAN ASSOCIATION OF CO-OPERATIVE BANKS

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Executive summary

This descriptive publication reviews developments in the overall performance of eighteen co-operative banking groups in thirteen European countries[1], on the basis of a range of selected indicators and with a focus on the latest available data of 2015. Their average performance is compared to that of the entire banking sector in the same countries.

The external environment poses many challenges for all banks. The European economy shows signs of recovery, but many uncertainties remain. Furthermore, the business model of retail banks, and co-operative banks in particular, has been upended by the monetary authorities' decision to drop interest rates to historic lows and into negative territory. The longer term consequences could well be profound, since co-operative banks are highly dependent on net interest income for the bulk of their earnings. Increasing regulatory costs and competition from incumbent and new players put additional pressure on their net profits. Cutting costs, conservative risk policies, and increasing efficiency via virtualisation of products and services are the dominant responses of banks to these challenges.

In these turbulent market conditions, co-operative banks managed to enlarge their member base by 1.6 million to almost 80 million in 2015. The member-to-population ratio equalled 19.2, against 18.9 in 2014. In line with their long-term member growth, the average domestic loan market share rose by 1.1 percentage point to 22.3 over the last five years. Their deposit market position improved by 0.5 percentage points to 21.9 in this time period. The branch market share jumped by 2.3 percentage points to 31.5, because all other banks closed more branches than co-operative banks. The branch network density of co-operative banks signal their emphasis on 'proximity' to members and customers in local communities.

The relatively large number of co-operative banks' branches does not lead to structurally higher cost to income ratios (CI-ratio). On the contrary, their average efficiency levels were alternately higher or lower than those of entire banking sectors since 2011. In 2015, both CI-ratios were actually very close and considerably lower than a few years earlier. The realised cost-efficiency gains by co-operative banks since 2011 are caused by different factors. Continued consolidation in the sector, i.e. mergers between local banks, and headcount

[1] Financial Group of the German Volks- und Raiffeisenbanken (Germany), Austrian Volksbanken Group (Austria), Raiffeisenbanken Group (Austria), Federazione Italiana delle Banche di Credito Cooperativo-Casse Rurali ed Artigiane (Italy), Unión Nacional de Cooperativas de Crédito (Spain), Banco de Crédito Cooperativo (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).

reductions are partial explanations for the improvement in their average CI-ratio from 65.5 in 2011 to 61.4 in 2015.

Divergent balance sheet developments between co-operative banks and entire banking sectors persisted in 2015. Total assets of co-operative banks remained stable, while those of all other banks shrunk by almost 2 per cent. In line with the modest economic recovery, loan portfolios of both clusters of banks expanded with 2.7 per cent. Deposits of co-operative banks grew by 5.8 per cent, while all other banks attracted 3.6 per cent more deposits than in 2014. Indexing balance sheet data at 100 in 2011, the dispersions between co-operative banks and the entire banking industry are more pronounced. Since 2011, total assets and retail loans of all other banks contracted, whereas they grew at co-operative banks. Moreover, the deposit expansion (10 per cent) of all other banks catches the eye. This reflects their strategic shift towards greater reliance on retail funding since 2011, which caused a decline in their loan-to-deposit ratio from a peak of 1.2 in 2008 to just above 1 in 2015. For co-operative banks, this ratio has hovered around 1 since 2004.

Over a longer term horizon, co-operative banks have on average outperformed all other banks in terms of Return on Equity (ROE). The ROE of co-operative banks also exhibits a more stable pattern over a longer time period. This might be due to the fact that co-operative banks are more involved in retail banking, which is normally associated with limited volatility in revenues. Overall profitability improved particularly for all other banks in 2015. The average ROE of both clusters of banks equalled 6% in 2015. The expectations for banks' future profitability remain bleak, though. Finally, bank capital positions improved further, helped by both capital increases and risk weighed asset declines. The average Tier 1 ratio of co-operative banks and entire banking sectors increased by 1 percentage point to 14.5 and 14.3, respectively.

Viewed over a longer time span, co-operative banking groups have always stood out from entire banking systems regarding many reported financial metrics. This holds for employment growth, branch network development, Tier 1 ratio and return on equity, etcetera. However, our analysis points to convergence in the indicators for both groups of banks in recent years. Though it may sound somewhat speculative, it cannot be ruled out that regulatory forces are particularly pushing banks in the same direction and/or prompt them to make similar choices (even though they have different ownership structures). For instance, surveys reveal that many banks are 'planning' to expand their retail activities, increase scale and digitalise their business activities. This may have particular implications for financial stability, because enforced uniformity in banking (models) could eventually lead to financial fragility instead.

Main features of co-operative banks

Co-operative banks have a long history and share basic principles. They are member-governed, private institutions. Membership is voluntary and open to customers of local or regional co-operative banks. Members have a multidimensional relationship with their co-operative bank. They are simultaneously owner, customer, supervisor and stakeholder (being member of the community). Banks with other organisational forms cannot replicate this member centricity. Elected member representatives populate local and central governance bodies of co-operative banking groups. Co-operative decision-making processes have a bottom-up nature, whereas commercial banks are generally managed in a top-down way. Members, or their representatives, largely determine the strategic course of the organization, generally based on the 'one-member, one-vote' principle.

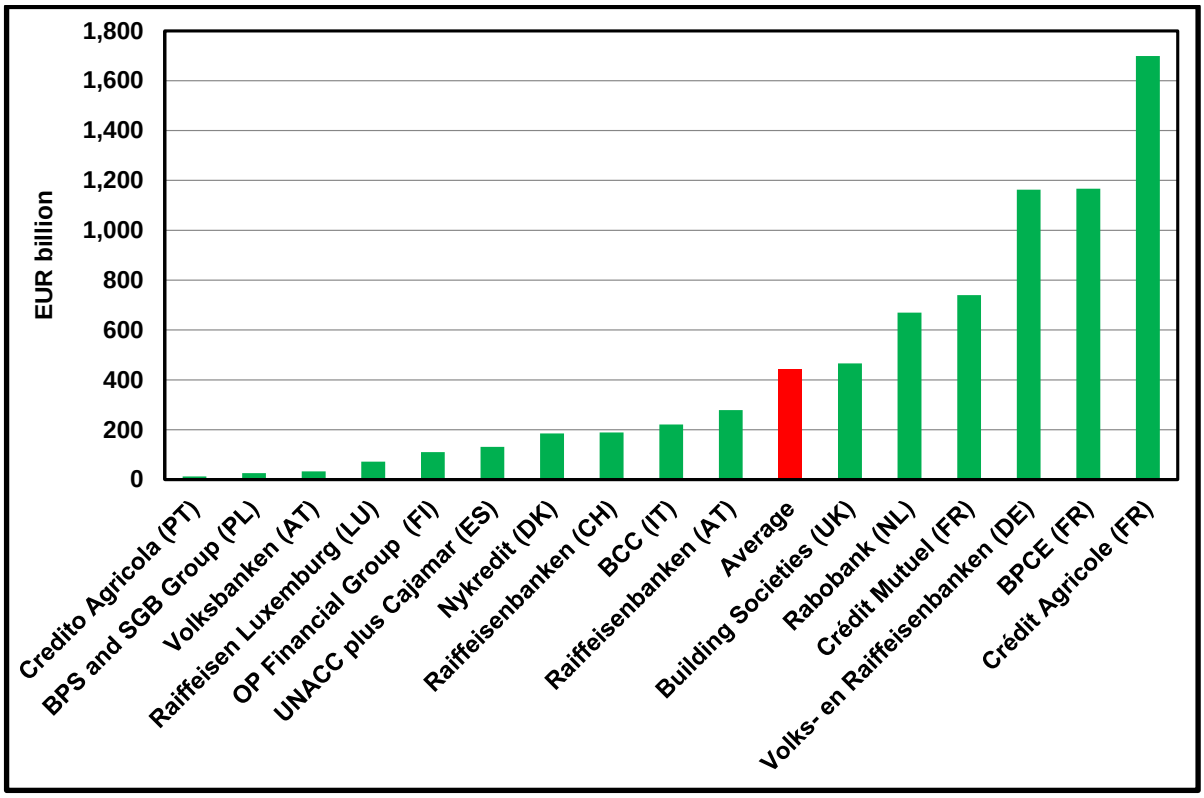
Co-operative banks operate within a decentralised network of affiliated banks (under the same brand) and are predominantly funded by retained earnings, member shares and retail deposits raised locally. They are committed to local presence and accountable to local members. In most instances, local/regional co-operative local banks have collectively set up a group-level entity, being an association, a co-operative or a corporation. Internally, they have established institutional frameworks and solidarity mechanisms, such as Institutional Protection Schemes, which sustain their structural stability.

Profits are not the ultimate goal of co-operative banks, but a means to accumulate capital, to absorb shocks, to invest and innovate, among other things. Profits are also needed for the realization of societal and/or social goals for their members. In other words, co-operative banks are 'dual bottom line' organisations. Based on these common features, it can be expected that co-operative banks have a different orientation, business model, and (financial) performance than banks owned by shareholders. This snapshot aims to shed light on the latter issue.

Within the co-operative banking sector, considerable diversity and heterogeneity exist. Figure 1 visualizes that co-operative banks vary widely in asset size. The divergent asset size mirrors many other differences between co-operative banking groups. For instance, larger co-operative banking groups are generally systemically important banks in their home countries and usually have a substantial international business and/or sizeable group entities outside the co-operative part of the organization. Their member base and domestic market shares are generally relatively large. Smaller co-operative banking groups are primarily focused on their home markets and they usually have fairly limited foreign activities and moderate domestic market shares. From a supervisory perspective, the latter groups belong

to the category of less significant institutions. Another difference between individual co-operative banking groups concerns the level of internal integration and consolidation. Furthermore, the governance and capital structure of individual co-operative banking groups vary greatly according to size. The take-away from this short analysis is that one cannot tar every co-operative banking group with the same brush, especially from a regulatory and supervisory perspective. A differentiated regulatory and supervisory approach is warranted for co-operative groups.

Figure 1 Total assets of European co-operative banking groups (2015)



Source: data collection by TIAS and EACB.

Note: the data pertain to entire co-operative banking groups. Apart from local/regional co-operative banks, the balance sheet total thus comprises domestic subsidiaries, central institutions and foreign activities (if any). For Poland, data limitations did not allow for making a distinction between the two Polish co-operative banking groups (BPS and SGB). The red bar denotes the average balance sheet total of all co-operative banking groups of around EUR 450 billion in 2015, which is virtually the same as in 2014.

Sample and data description

The number of included co-operative banking groups has on balance increased by three to eighteen compared to previous editions of the snapshot. On the one hand, the Italian *Banche Popolari* (BP's) are removed from the sample. The reason is that the largest BP's will be converted into public limited companies by decree of the Italian government. In 2014, their collective domestic market share in various retail banking segments amounted to approximately 20 per cent. The Italian *Banche di Credito Cooperativo* remained in the sample. On the other hand, the sample is enlarged with member-governed financial institutions in Luxembourg, Poland and the United Kingdom. For the latter country, the building society sector is incorporated in the sample.[2]

Consequently, the aggregated data of this publication cannot be compared to those of the previous ones. The reported time series for each indicator in the current edition are fully consistent, though. For each single year, aggregated and/or average variables have been calculated using data of the same population of financial co-operatives. Data for key co-operative and financial indicators of individual co-operative banking groups are collected by TIAS.[3] In most cases, individual figures are either derived from public sources or composed upon request for TIAS. For some co-operative banking groups, TIAS approximated particular indicators by combining different data sources. Furthermore, judgment was required to categorize the various balance sheet items (e.g. loans, deposits, equity) in order to obtain comparable data for European co-operative banking groups. Indeed, accounting conventions and terminologies as well as the detail of disclosure seem to differ somewhat between co-operative banks.

This snapshot covers more national banking systems than previous reports. The sample is extended with the banking sectors of Luxembourg, Poland and the United Kingdom. This broader country coverage enriches the analysis. Due to discontinued data publications for a number of countries, some time series of national banking sectors were retrieved from different sources (e.g. national supervisory authorities, Eurostat, European Central Bank, International Monetary Fund and the World Bank). If necessary, TIAS has adjusted the data for breaks.[4]

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[2] Technically speaking, building societies are mutual organisations and not 'banks'. They do not offer the full range of banking services. However, both co-operative banks and building societies belong to the subset of stakeholder-based financial institutions.

[3] For the non-euro countries in the sample, all items were converted into euro at the exchange rate prevailing at the statement date.

[4] To test the robustness of the calculations, we have computed our selected indicators with slightly different definitions and/or alternative data sources. This exercise demonstrates that the development pattern of the variables under review is insensitive to the selected data bases and/or applied definitions.

This publication focuses on the aggregated co-operative banking sector. We do not pay attention to individual co-operative banking groups. When appropriate, their consolidated data are contrasted with aggregated data for entire banking sectors in their countries. One might wonder whether this approach is methodologically sound, because co-operative banks do not operate in identical external environments and are faced with different conditions in banking. In our view, the validity of the analysis is not compromised by differing external environments for co-operative banks. The reason is that the performance of each co-operative banking group is assessed in relative terms. Its aggregated and averaged key indicators are compared to those of all other banks in their respective countries. Since the activities of all other banks are executed in the same external environment, our approach yields an accurate comparison at the aggregated level. Hence, we are able to investigate whether the whole European co-operative banking sector performed significantly different from entire banking systems or not.

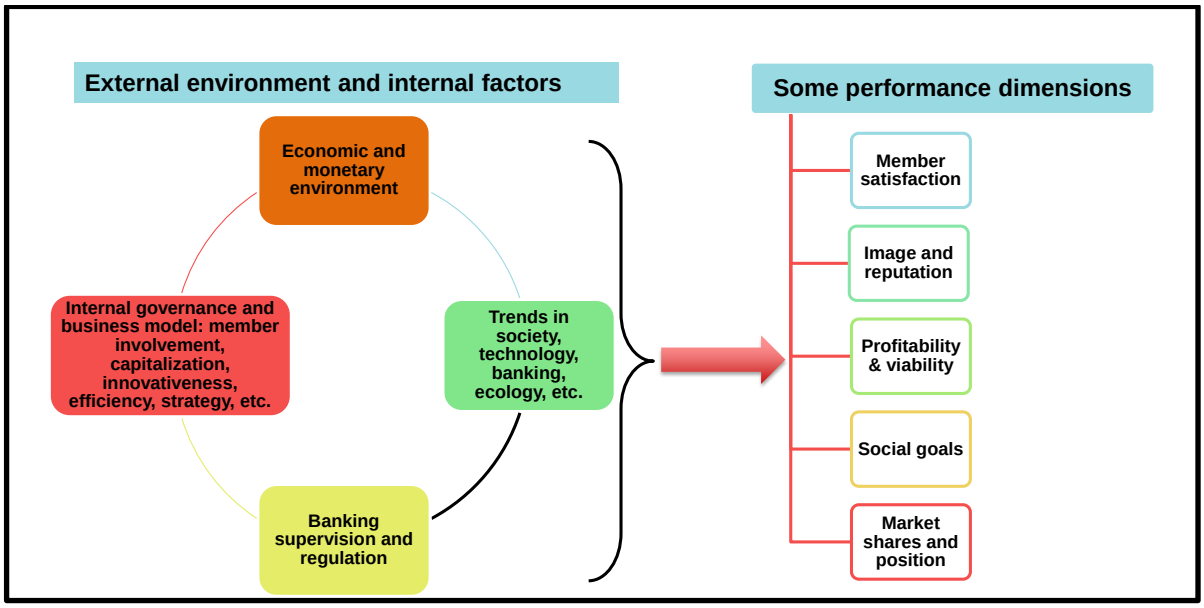
In this report, the focus lies on quantifiable performance indicators. However, the performance of any co-operative bank cannot be assessed by looking solely at quantitative indicators or hard data. Due to their 'dual bottom line' approach, it is also inappropriate to use only financial variables to compare co-operative banks with other banks. Aside from these qualifications, the concept of 'performance' has many dimensions: the degree of customer satisfaction, customers' perception that the bank acts in their interests, the access offered to networks and knowledge of the bank, the stability/duration of relationships, the perceived attention/concern for the environment and local communities, et cetera.

Bearing in mind these qualifications, a number of standard bank performance metrics will feature in this report. Given the wide range of potential indicators, we had to make a selection. After a brief and general discussion of external and internal determinants of bank performance, we focus on a key co-operative indicator: the evolution of the member base. The following section documents the number of local/regional co-operative banks, domestic branches and employees. Thereafter, balance sheet characteristics of European co-operative banks are contrasted with those of all other banks. Movements in domestic market shares are logically associated with these balance sheet developments. Subsequently, profitability, capitalisation and efficiency measures for co-operative banks will be reviewed and compared with those of the entire banking sector.

External environment and internal factors

As explained in the previous section, the performance of co-operative banks encompasses many dimensions. Figure 2 shows important interconnected factors that determine every dimension of bank performance. A rough distinction can be made between external and internal factors. The external environment is largely exogenous for individual banks. Internal factors pertain to the design and functioning of the governance, the innovativeness, and the business and distribution model, among other things. In Scheme 1, we picture the dynamic and challenging context in which co-operative banks have to operate to date.

Scheme 1 External and internal factors and bank performance



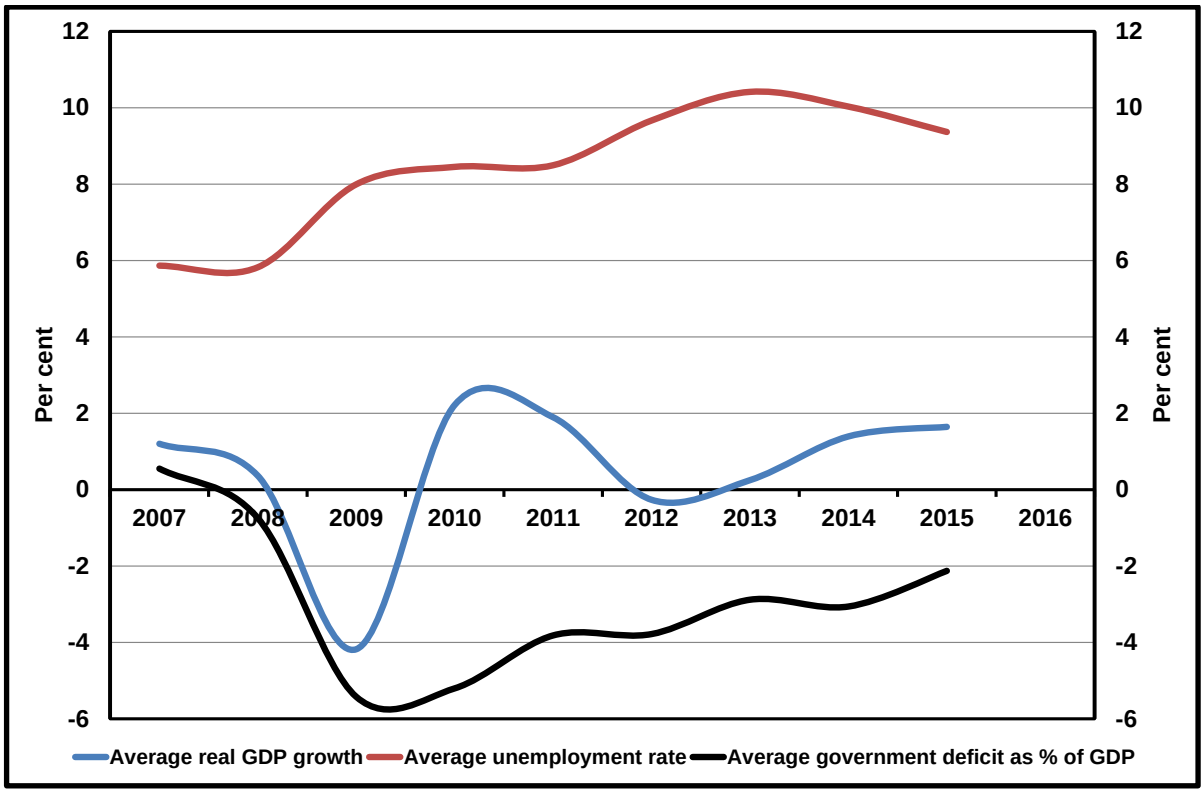
Source: TIAS

Any assessment of the overall financial performance of co-operative banks over the last decade (2006-2015) has to take into consideration the highly differentiated macroeconomic environment (Figure 2). Over the past several years, the sluggish growth in Europe's economy catches the eye. In 2015, average economic growth amounted to less than 2 per cent in the thirteen countries under review. Country differences in economic growth remained wide in 2015, though. Finnish GDP growth was just 0.2 per cent, whereas the Luxembourg economy grew by almost 5 per cent. Low energy prices and very loose monetary policies by central banks could have boosted industrial production and trade, but this effect was counterbalanced by global political uncertainties and an economic slowdown in China. A glimmer of light is the continued fall in the average unemployment rate to around 9 per cent. Consequently, consumer confidence and consumer spending also increased moderately. Like economic growth, the labour market situation differs across countries. In Spain, the jobless rate dropped by almost 3 per cent during 2015, but still exceeded 20 per cent. By

contrast, the unemployment rate stood at 5 per cent in Germany. On average, government budgets ameliorated slightly as well.

Monetary policy also shapes the enabling environment and has a significant impact on the performance of retail banks, among which co-operative banks. The current ultra-expansionary monetary policy is unprecedented and is gradually adversely affecting the balance sheet composition and profitability of many retail banks. This low interest rate policy could eventually imperil the viability of retail banks, and co-operative banks in particular, because they cannot adjust their business models so rapidly to offset dropping interest revenues from their retail banking activities and/or to boost their cost efficiency. Adjusting or diversifying business models is a complicated and costly process for both more complex institutions and smaller, less complex banks with just a few business lines. Besides, forced modifications to business models could actually conflict with the main purpose of co-operative banks to serve members and may even lead them astray.

Figure 2 Development of key economic variables in thirteen European countries (average)



Source: Calculations by TIAS based on data from Eurostat and the European Commission. The lines symbolize the average values of the displayed variables in ten European countries.

From a regulatory and supervisory perspective, the enabling environment for co-operative banks also changed fundamentally in recent times. First, regulatory compliance and supervisory costs and capital and liquidity requirements have understandably surged

substantially after the Great Financial Crisis, but these factors put additional pressure on banks' profitability. 2015 also marked the first year of operational existence of the Single Supervisory Mechanism (SSM) and the establishment of the Single Resolution Mechanism in the Eurozone. The SSM has made extensive efforts to lay the foundations for harmonizing supervision across the euro area. This poses a challenge for co-operative banks to bring to the fore their specificities like internal network arrangements and governance structures, which deviate significantly from those of joint stock companies. Paradoxically, rising regulatory costs are complicating the internal capital-generation capacity of co-operative banks, since they heavily rely on retained surpluses to solidify their capital buffers, as is required by the same regulators and supervisors. This 'regulatory compliance cost risk' applies particularly to smaller and medium sized co-operative banks for which the combined compliance costs are about to jeopardize their viability.

New entrants and competitors in banking, for instance FinTech start-ups, are also threatening revenues and forcing incumbent banks to implement efficiency programs and to reduce costs. FinTechs spur innovation and accelerate the transformation of banks. Digitalization of products and services is an additional powerful driving force in banking. This trend requires large investments, but also changes the nature of the contacts with members and customers from physical to virtual encounters. Finally, the price as well as the quality of – virtual – products and personal advice are key components of customer satisfaction and bank performance.

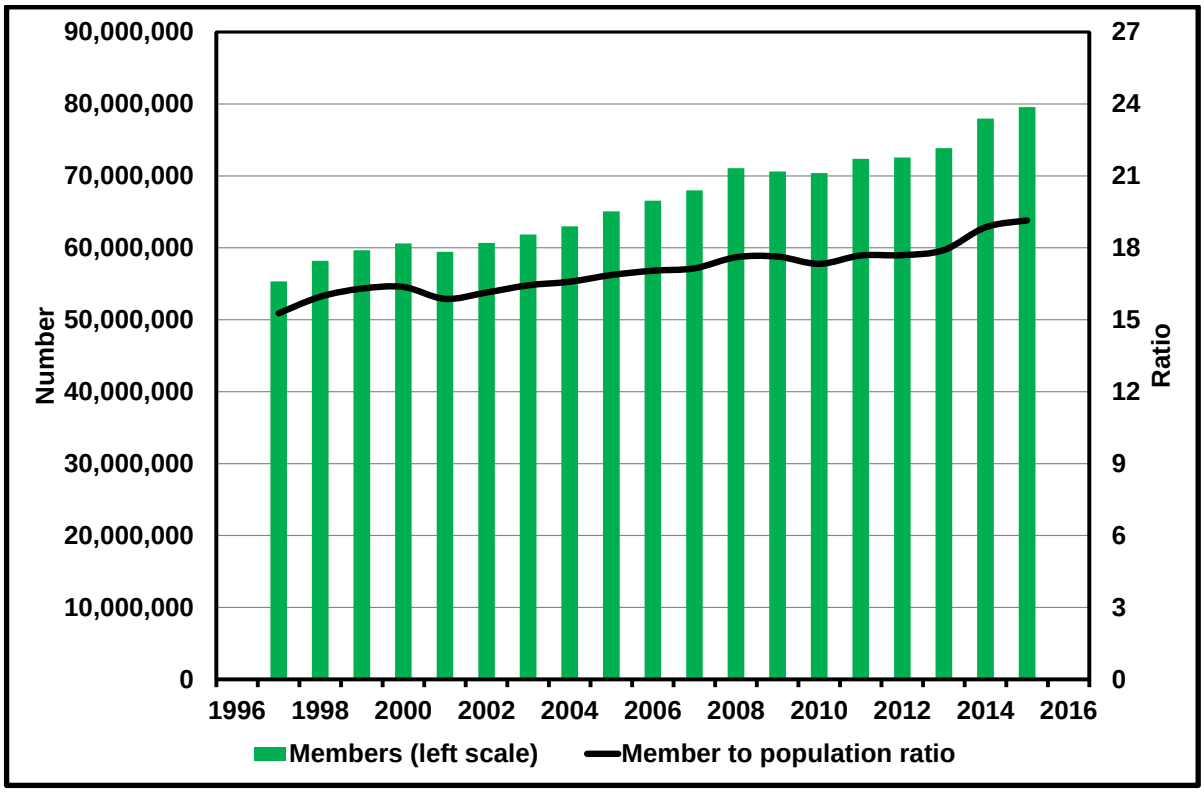
Regarding internal factors, the design and actual functioning of governance structures and decision-making mechanisms are important determinants of the overall performance. A wide array of co-operative and banking aspects are associated with both elements. It is about membership policy, member engagement and involvement, the participation of local banks in communities and networks, local autonomy, etcetera. From a banking perspective, factors like agility, innovativeness, efficiency, price and quality of products and services, and, last but not least, financial viability and internal capital building capacity are impacting on their overall performance.

Members

Members and their elected representatives are an essential asset and actually embody the legitimacy for co-operative banks. Mainly due to trends in society, compulsory membership has been abolished many years ago, except for UK building societies. Nowadays, most co-operative banks also serve large numbers of non-members. Rising number of members may be due to countless factors: financial benefits, immaterial advantages, affinity with the brand, satisfaction with products and services, social goals, co-operative donations, etcetera. In fact, it is all about the 'perceived member value'.

Figure 3 shows the number of members and the member-population ratio since 1997. On average, the member base expanded by 2 per cent each year.[5] The total number of members rose from around 55 million in 1997 to almost 80 million in 2015. In 2015, European co-operative banks welcomed 1.6 million new members.

Figure 3 Number of members and member to population ratio



Source: Calculations by TIAS based on data from co-operative banking groups and national demographic statistics.

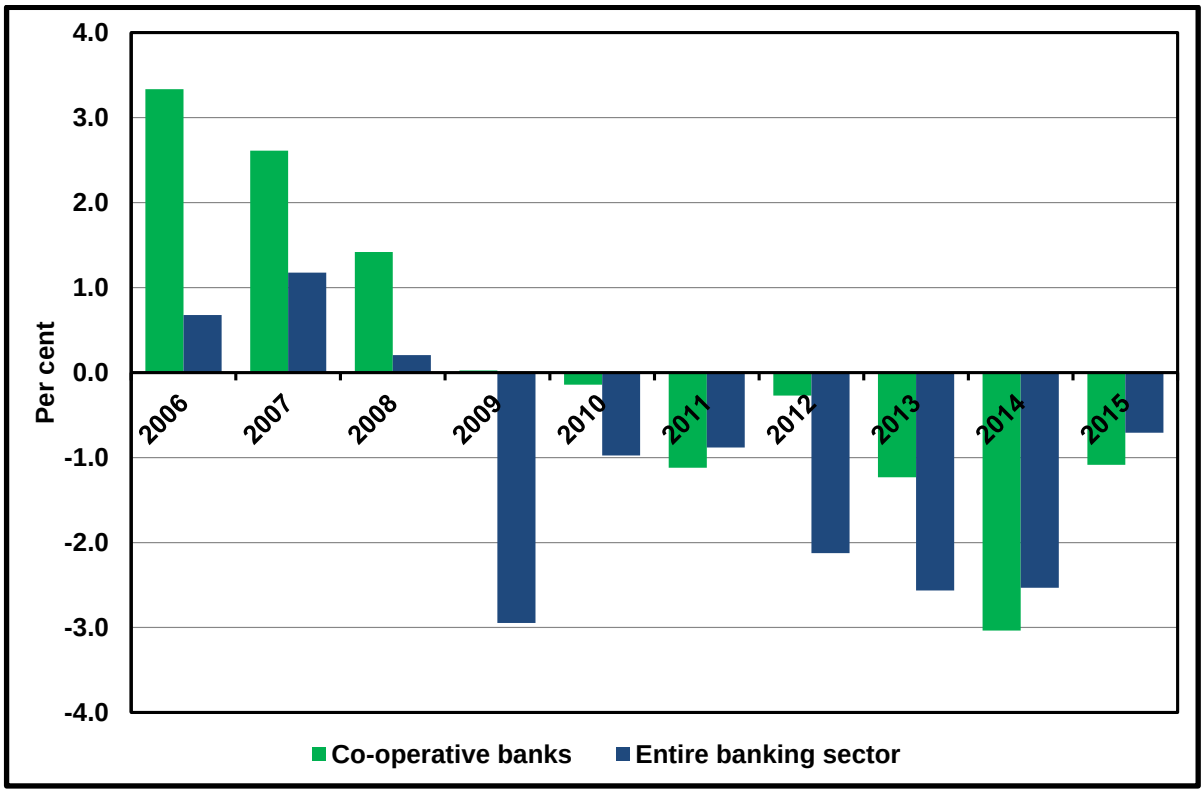
[5] Disregarding the UK building societies, this figure would have been 2.6 per cent. Since 1997, a number of British Building Societies have been demutualized or acquired by another bank which caused a decline in the number of members of all co-operative banking groups in the sample (ceteris paribus).

Member growth has continuously surpassed population growth as evidenced by the upward trend in the member to population ratio. This ratio rose from 15.3 in 1997 to 19.1 in 2015. To put it another way, almost one out of five inhabitants of the European countries under review is currently a member of a co-operative bank. The increase signals trust and confidence of customers in co-operative banks. Indeed, clients are presumably not very eager to become and stay a member of local co-operative banks if the level of trust and satisfaction would be low.

Number of local banks, branches and employees

In line with developments relating to the overall banking market structure, the co-operative banking sector prolonged its consolidation process. The driving factors are increasing pressure for cost containment, deleveraging and restructuring. The number of independent local or regional co-operative banks continued its year-long decline, dropping 2.3 per cent to 3,345 in 2015. The same holds for the number of branches that fell by 1.4 per cent to 55,235 in 2015. Like in preceding years, co-operative banks have reduced their physical presence in local societies at a more moderate pace than all other banks. Since 2011, co-operative banks closed down around 3.5 per cent of their branches, whereas all other banks cut back banking outlets by almost 11 per cent. We feel that this difference can be partly explained by their specific governance which translates into a particular business orientation and distribution philosophy. Physical proximity to members and customers is deemed to be essential for maintaining and strengthening close ties with local communities.

Figure 4 Employment change (2006-2015)



Source: Calculations by TIAS based on figures from co-operative banks and various supervisory authorities and central banks.

We have collated employment data for all co-operative banks and entire banking sectors for the period 2006-2015. Apart from the fact that the Great Financial Crisis of 2008 marks a turning point for all banks, the divergent employment pattern in the entire sample clearly

stands out from Figure 4. Just before the Great Financial Crisis, employment at co-operative banks increased much more than total banking industry employment. In 2009, all other banks shed staff by almost 3 per cent, whereas employment at co-operative banks remained stable. Plausibly, non-co-operative banks were on balance more severely hit by the crisis as a result of their relatively greater focus on non-retail banking activities. Income from trading, fees and commissions plunged and staff employed in the associated activities was partly laid off. Since 2010, headcount at all banks declined on average. It can be observed that the number of staff in the entire banking sector contracted significantly stronger than that at co-operative banks in 2012 and 2013. In 2014 and 2015, it was exactly the other way round. It seems that co-operative banks are currently adapting to the challenges and changes in the external environment as described above.

Today, entire banking sectors and co-operative banks have approximately 12, respectively, 7 per cent fewer bank employees than in 2008. This downward trend in employment is likely to persist – and we believe it will actually intensify over time – due to many interacting forces such as increasing competition in retail banking, virtualisation of products and services, conditions laid down in restructuring plans of banks that received state aid, scaling back activities in risky banking areas, retrenchment in foreign activities, and an increasing urge to improve cost efficiency.

Balance sheet developments

Balance sheet data for co-operative banks and the entire banking sector (excluding co-operative banks) for the period 2012-2015 are provided in Table 1. Balance sheet developments of co-operative banks and all other banks are clearly shaped by cyclical and structural factors. In 2012, total assets of co-operative banks (TA_{COOP}) still showed a moderate increase of around 1.3 per cent, while total banking sector assets (TA_{EBS}) contracted by 0.7 per cent. In 2013, TA_{COOP} decreased as well, which is quite exceptional from a historic perspective. However, this decline was rather modest compared to the plunge in TA_{EBS} of about 9.5 per cent. The latter development was partly the result of bank restructuring and resolution processes in some countries as well as reconsiderations of business models by a number of banks. Asset growth resumed sharply in 2014, though the growth rates diverged considerably. TA_{COOP} grew by 5.3 per cent, whereas TA_{EBS} surged by 8.8 per cent. In the most recent year, TA_{COOP} remained constant, while TA_{EBS} diminished by almost 2 per cent. Hence, TA_{EBS} has fluctuated much stronger than TA_{COOP} during this time span. This finding exemplifies the divergent behaviour and business model of co-operative banks.

Table 1 Asset, loan and deposit development

	2012		2013		2014		2015		2011 = 100	
	COOP	*EBS*	*COOP*	*EBS*	*COOP*	*EBS*	*COOP*	*EBS*	*COOP*	*EBS*
Total assets	1.3%	-0.7%	-2.9%	-9.4%	5.3%	8.8%	0.0%	-1.8%	103	96
Loans	1.7%	0.1%	-0.1%	-4.2%	3.1%	0.6%	2.7%	2.7%	108	99
Deposits	3.2%	1.9%	0.7%	0.7%	4.2%	3.6%	5.9%	3.8%	115	110

Source: Calculations by TIAS based on data from co-operative banks, the ECB and national supervisory authorities and/or central banks.

Note: *COOP* and *EBS* stand for co-operative banking groups and the Entire Banking Sector in 13 European countries, respectively (see footnote 1). *EBS* data do not comprise *COOP* data. Loans refer to total loans and advances to the non-financial private sector. Retail deposits refer to all deposits and savings from the non-financial private sector. Upon close inspection of balance sheet items, we have tried to use comparable definitions for 'loans' and 'deposits' of individual co-operative banks and entire banking systems. Since we have used the same definitions every year, data consistency is guaranteed.

Regarding loans of co-operative banks ($LOAN_{COOP}$) and the entire banking sector ($LOAN_{EBS}$), a fairly similar pattern emerges. The percentage change of $LOAN_{COOP}$ differed significantly from that of $LOAN_{EBS}$ in most years of the sample. In 2012, $LOAN_{COOP}$ increased and $LOAN_{EBS}$ remained virtually constant. Co-operative banks could not escape from the successive economic and financial turbulences as mirrored in a minor reduction in their lending portfolio in 2013. This tiny drop is in sharp contrast with the contraction of $LOAN_{EBS}$

of more than 4 per cent. In 2014, $LOAN_{COOP}$ growth substantially surpassed the percentage expansion of $LOAN_{EBS}$. Only in 2015, the growth rate of $LOAN_{COOP}$ equalled that of $LOAN_{EBS}$.

With the exception of 2013, deposit growth at co-operative banks (DEP_{COOP}) has outpaced deposit expansion of the entire banking system (DEP_{EBS}). It can also be concluded that the funding of loans has shifted towards deposit financing for all banks. In every year recorded in the table, deposit growth surpassed loan expansion (contraction).

In the last column, total assets, loans and deposits are indexed at 100 in 2011. These figures uncover structural differences between co-operative banks and the entire banking sector from another angle. TA_{COOP} and $LOAN_{COOP}$ are higher than in 2011, whereas the opposite is true for TA_{EBS} and $LOAN_{EBS}$. The European Investment Fund finds a similar result and concludes that this reflects co-operative banks' commitment to finance the real economy. Both DEP_{COOP} and DEP_{EBS} have increased substantially since 2011, although the former rose considerably stronger. The positive gap between deposit and credit expansion since 2011 partly reflects banks' shrinking preference for wholesale funding sources as a result of new regulatory requirements and the increased cost of wholesale funding. The latter developments are causing a steady decline in the loan-to-deposit ratio. Underlying figures show that the average loan-to-deposit ratio of co-operative banks and the entire banking sector has dropped to 0.97, respectively, 1.03 in 2015.

Domestic market shares

Since 2011, the average domestic market shares of co-operative banks in retail loans and retail savings increased by 1.1 and 0.5, respectively. Collectively, co-operative banks serve more than one fifth of the retail banking markets in their home countries. The underlying data show that every co-operative banking group gained loan market share in this period. For deposit market shares, the picture is ambiguous. Two thirds of the co-operative banking groups won some deposit market share in the period under review. Tougher competition for deposits from players seeking to reduce their dependency on wholesale funding is presumably a part of the explanation for the loss of deposit market share of five co-operative banking groups in our sample.

Table 2 Average domestic market shares of co-operative banking groups

	2011	**2012**	**2013**	**2014**	**2015**	**Change in percentage points (2011-2015)**
Loans	21.2	21.5	21.8	22.1	22.3	+ 1.1
Deposits	21.4	21.9	22.1	21.9	21.9	+ 0.5
Branches	29.1	29.6	30.7	31.4	31.5	+ 2.3

Source: Calculations by TIAS based on data from co-operative banks (see footnote 1), the ECB and national supervisory authorities.

Over the entire time span, branch market share of co-operative banks has climbed significantly. Although co-operative banks collectively closed more than 2,000 branches, other banks have limited their geographical coverage to a much greater extent, i.e. they have closed around 20,000 branches.

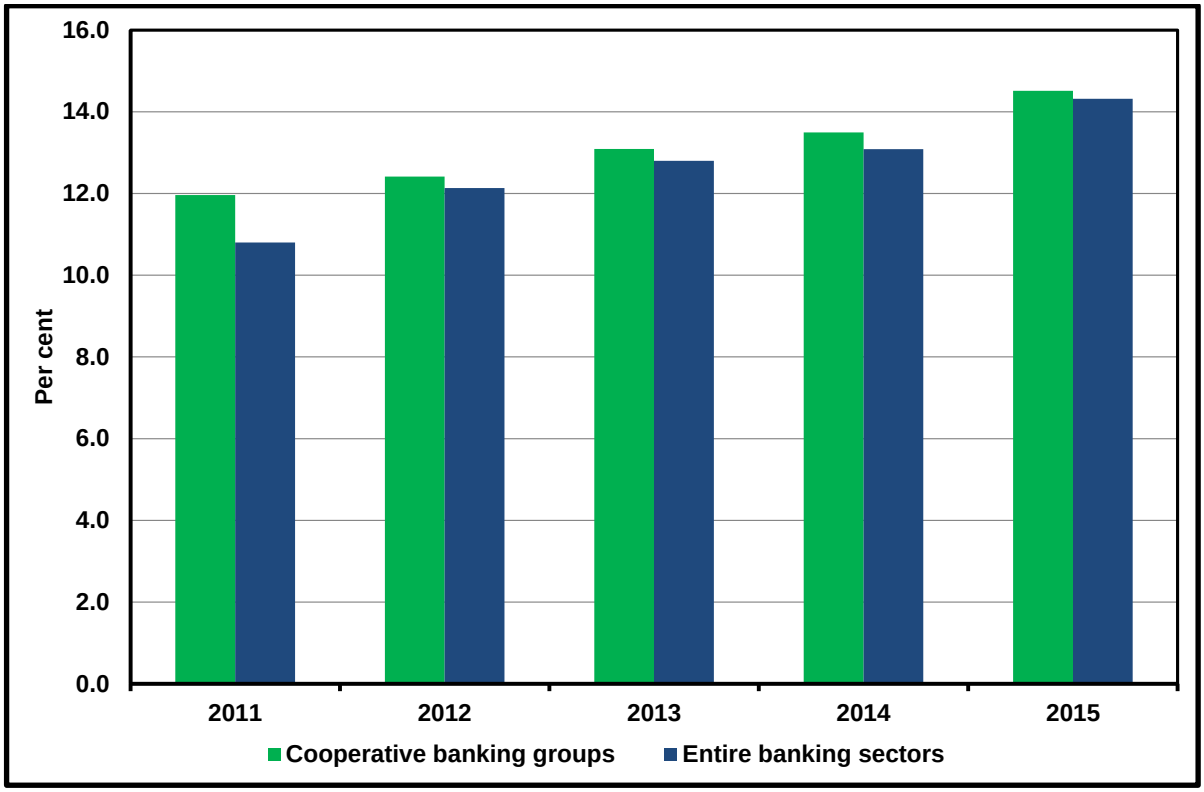
Financial indicators

This section assesses three commonly used indicators for the financial performance of banks. These variables are clearly interrelated as will be discussed below.

Capitalization

The global financial crisis of 2008 has illustrated that banks operating with less equity were more likely to fail or to be in need of state support. Since then, regulatory requirements have become stricter to prevent a recurrence of such a crisis. The reforms raised both the quality and quantity of the regulatory capital base and enhanced the risk coverage of the capital framework. Capital buffers have been strengthened considerably vis-à-vis risk weighed assets. This has resulted in an increase of capital ratios, i.e. a measure of bank capital divided by the amount of risk weighted assets (RWA).

Figure 5 Average Tier 1 ratio of co-operative banking groups and the entire banking sector



Source: calculations by TIAS based on data from co-operative banking groups, national supervisory authorities, and the ECB.

Note: Not all co-operative banking groups report Tier 1 ratios. To ensure sample consistency throughout this snapshot, we have used the equity to asset ratio, i.e. the inverse of the leverage ratio, for co-operative banking groups and entire banking sectors in Luxembourg and Spain in our calculations. We are aware of the fact that this solution lowers the 'average Tier 1' ratio, since the equity to asset ratio lies below the Tier 1 ratio by definition. However, the overall comparison of co-operative banks against entire banking systems remains accurate.

Figure 5 demonstrates that the average Tier 1 ratio of co-operative banks ($Tier_{COOP}$ 1) was significantly higher than that of entire banking sectors ($Tier_{EBS}$ 1) in 2011. This corresponds with earlier research that co-operative banks were better capitalized before and just after the Great Financial Crisis. Many other banks were required to raise additional capital to comply with the new rules and the resulting higher average risk-weighted assets. The gap between $Tier_{COOP}$ 1 and $Tier_{EBS}$ 1 has consequently narrowed since 2012.

The resilience of the banking sector improved further in 2015. Both co-operative banks and entire banking sectors were able to increase their average Tier 1 ratio by almost 1 per cent to around 14.5. The ECB attributes this increase to higher capital buffers and de-risking and reshuffling of portfolios towards safer assets by quite some banks. It should be pointed out that the composition and generating process of capital or equity at co-operative banks differ from listed banks in particular. The equity of listed banks consists for the greater part of floating stocks, whereas co-operative banks have to rely primarily on member shares and retained profits for their capitalisation.

Return on equity

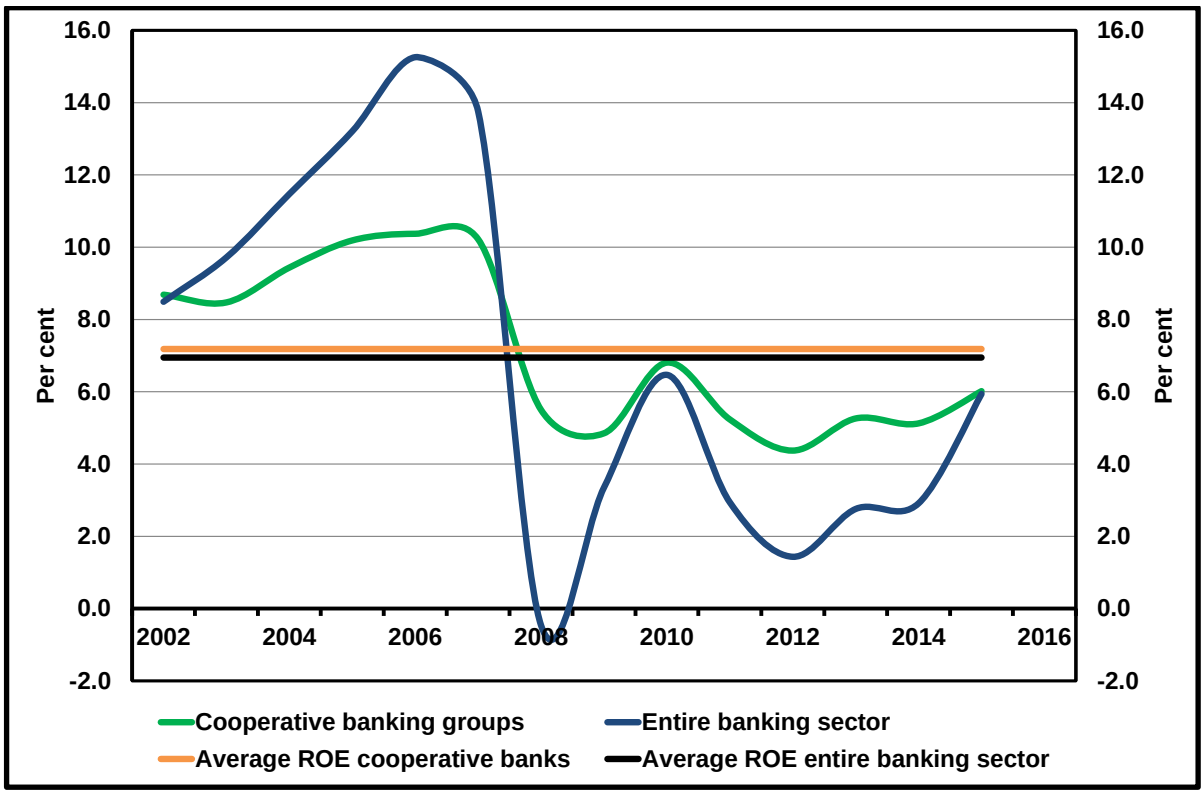
The return on equity (henceforth ROE) is a common measure of profitability. It is typically defined as net income divided by the book value of equity (or capital and reserves). A bank's ROE can be changed in two ways: through a change in net income or by operating with more or less equity. Figure 6 displays the ROE of co-operative banks (ROE_{COOP}) and national banking sectors (ROE_{EBS}) over the time span 2002-2015. This period covers years of economic prosperity and financial stability and economic slack and financial distress.

Various inferences can be drawn from this figure. On the whole, pre-crisis profitability levels of the entire non-co-operative banking sector were boosted by high leverage and/or dependency on relatively cheap wholesale funding as well as, in a number of cases, elevated risk taking – such as real estate lending and securitisation exposures – in order to create revenues. In these economically prosperous times, the ROE_{EBS} exceeded the ROE_{COOP} substantially. When the crisis broke out, the category 'all other banks' was on average severely hit and some distressed banks needed state aid to survive or even went bankrupt. The conditions attached to government support forced the surviving banks to shift their business models towards traditional banking activities, to scale back their activities in risky areas, and/or to reduce their leverage and over-reliance on wholesale funding sources.

Changes in banks' behaviour, the regulatory framework, and the external environment have led to deteriorating financial performance since the crisis. The era of double-digit ROEs ended abruptly in 2008. Strikingly, the drop of ROE_{EBS} has been more pronounced than the decline in ROE_{COOP}. It can be safely said that this dispersion is mainly due to the stronger

focus on retail businesses by co-operative banks which inherently result from member ownership. Retail banking is generally less risky and accompanied by milder revenue fluctuations. Furthermore, the crisis sparked a move back to retail banking by many banks. This trend is predicted to continue in the next few years. Many institutions and analysts also envisage a prolonged period of weak profitability due to cyclical and structural factors in banking. The reappearance of double-digit ROEs is unrealistic. Indeed, bank balance sheets have to contain more and higher quality capital. This will ameliorate the loss absorption capacity of banks, but will dampen the ROE. Besides, regulators will not allow banks to engage in excessive risk-taking to boost net income again.

Figure 6 Return on Equity of co-operative banking groups and entire banking sector



Source: calculations by TIAS 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 span 2002-2014.

Another observation is that the swings in the green and blue line in Figure 6 point to a much lower volatility of ROE_{COOP} vis-à-vis ROE_{EBS}. This demonstrates once again the orientation towards retail business lines of co-operative banks. Over the entire sample, the average ROE_{COOP} (7.2) surpassed the average ROE_{EBS} (6.9). Since 2008, ROE_{COOP} has been systematically higher than ROE_{EBS}. In 2015, both ROEs were around 6 per cent. The fierce improvement of ROE_{EBS} since 2012 is partly attributable to a continued reduction of risk

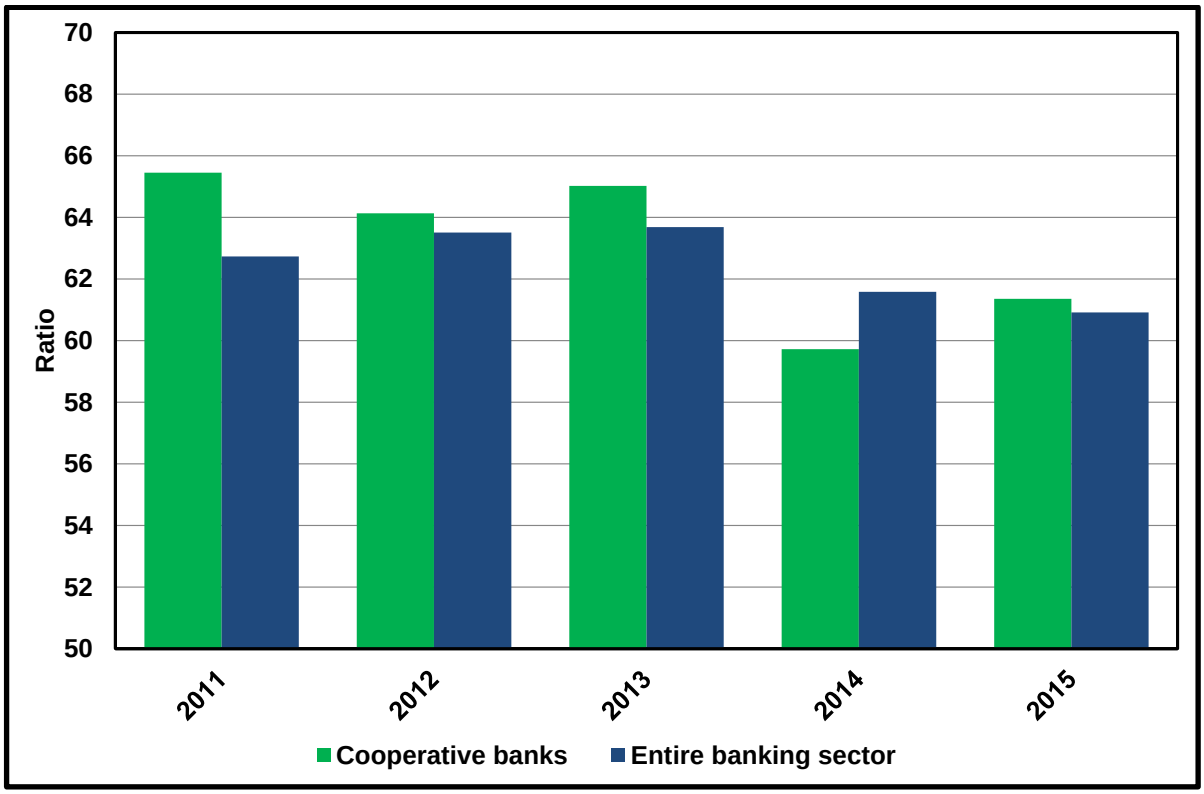
provisions, as many banks are cleaning up their balance sheets and remain cautious about taking on new risks. A decrease in operational costs, related to branch network rationalisation and headcount cuts, led to an improvement of ROE_{EBS}.

Efficiency

A proxy for banks' efficiency is the cost-income ratio, defined as net operational costs divided by net operating income. A high CI-ratio indicates a low efficiency and vice versa. Based on the increasing branch market share, one could be tempted to assume that co-operative banks perform unfavourable on this ratio. Indeed, maintaining fairly dense branch networks is expensive.

Figure 7 belies this assumption. Co-operative banking groups only had a significantly higher CI-ratio in 2011. In 2012 and 2013, the ratios were not statistically different. In 2014, it was the other way round; co-operative banks operated significantly more efficient. In 2015, the CI-ratios were identical again with a value of around 61. The Figure also reveals the impact of rationalisation and resizing in banking. The CI-ratios have clearly dropped since 2011.

Figure 7 Cost-income ratio of co-operative banking groups and the entire banking sector



Source: calculations by TIAS based on data from co-operative banking groups, the European Central Bank and the Swiss National Bank.

Concluding considerations

Profitability prospects for banks look weak as a result of an operational environment characterized by low interest rates in a subdued economic outlook. Stricter capital requirements, surging regulatory costs and rapid technological innovation will create additional pressure on profitability. Financial analysts and supervisors assert that cyclical and structural challenges will prompt banks to bring down their overall cost levels via restructuring plans and/or via adapting their business models in the near future. This will pose particular challenges for co-operative banks that largely depend on net interest income, i.e. the difference between the amount they pay customers for deposits and what borrowers pay them for loans. As the interest rates have been pushed ever lower, this income stream is considerably squeezed.

The ownership structure influences the internal dynamics and business orientation of a bank. If member representatives are able and capable to exert a disciplinary influence on managers of co-operative banks and to set the strategic course, their external orientation and market performance can be expected to deviate from those of banks with other ownership structures. For example, listed banks are primary driven by the demand of anonymous owners (shareholders) to provide a regular return on their invested capital in the form of dividends. Changes to their business models are mainly initiated by market pressures from external investors. The point is that different ownership structures prevent the banking landscape of becoming monotonic. Too much uniformity in banking renders the sector vulnerable to shocks affecting all banks in the same way and to the same degree, i.e. the systemic stability is undermined.

Policy-makers and supervisors should, therefore, refrain from measures that eventually yield a strong convergence of business models, governance structures and scale of banks. Diversity can be easily destroyed, but is very difficult to regenerate. A marginalisation of biodiversity in banking will have a detrimental impact on competition and stability. It could also lead to negligence, or exclusion, of certain customer, business and/or economic segments in society. Recent history has demonstrated that a kaleidoscopic banking sector lowers the risk of fierce market disruptions. Hence, a great responsibility lies with these professional groups to foster a healthy level of heterogeneity in terms of scale, ownership structures, business orientations and risk profiles. This requires genuine interest in and an unbiased attitude towards different categories of banks. It must be acknowledged that a complicated trade-off exists between the trinity of (economic, regulatory, supervisory) efficiency, financial stability and competition.

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Also in recent years, the external orientation and market performance of European co-operative banks have objectively deviated from those of banks with other ownership structures. This snapshot calls upon policy-makers and supervisors to foster a healthy level of heterogeneity in terms of scale, ownership structures, business orientations and risk profiles in European banking. Recent history has learned that a kaleidoscopic banking sector lowers the risk of fierce market disruptions.