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Savings Banks and Cooperative Banks in Europe

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Abstract

Until about 25 years ago, almost all European countries had a so-called "three pillar" banking system comprising private banks, (public) savings banks and (mutual) cooperative banks. Since that time, several European countries have implemented far-reaching changes in their banking systems, which have more than anything else affected the two "pillars" of the savings and cooperative banks. The article describes the most important changes in Germany, Austria, France, Italy and Spain and characterizes the former and the current roles of savings banks and cooperative banks in these countries. A particular focus is placed on the German case, which is almost unique in so far as the German savings banks and cooperative banks have maintained most of their traditional features. The article concludes with a plea for diversity of institutional forms of banks and argues that it is important to safeguard the strengths of those types of banks that do not conform to the model of a large shareholder-oriented commercial bank.

1. The aim and the structure of the paper

Historically, savings banks and cooperative or mutual banks have played an important role in the financial systems of almost all European countries. However, the wave of financial deregulation, liberalization and privatization in the late 20th century has changed the role and the institutional forms of these banks in most European countries. The general tendency of the past years was to regard these types of banks as somehow old-fashioned, outdated and inefficient, and to advocate and even implement policies that correspond to this view. In some European countries, savings and cooperative banks have completely disappeared as specific groups of financial institutions, and in some others, they have changed so much that it suggests asking whether there is still today any substantial difference between these banks and conventional national and international commercial banks in the legal form of a corporation and with the set of objectives that private banks can be assumed to have.

However, under the influence of the financial crisis, the formerly widely held critical view of savings and cooperative banks might give way to a more friendly assessment. After all, many big private banks had incurred so much risk that policy makers and regulators have adopted a skeptical view of their merits and are now trying to find ways of limiting their riskiness. Indeed, many current policy initiatives try to make all banks behave a bit more like the savings banks and cooperative banks of yesteryear.

Apart from the important role that savings banks and cooperative or mutual banks play in several European banking systems, studying these two groups of banks is particularly interesting because of their unconventional organizational design, which sets them apart from private banks that solely operate in the interests of their shareholders. This is why this paper puts special emphasis on the aspect of institutional design.

The aim of this article is to characterize the former and the current roles of savings banks and cooperative banks, to provide a brief account of the recent changes and also to speculate about their future prospects. This aim determines the structure of the article. In the next section, we characterize savings and cooperative banks in Europe by pointing out their former characteristic features. Then we turn to their recent development in different countries. We first address the German case, which is almost unique in so far as the German savings banks and cooperative banks have maintained most of their traditional features, and then take a brief look at other European countries. The article concludes with a plea for diversity of institutional forms of banks and argues that it is important to safeguard the strengths of those types of banks that do not conform to the model of a large shareholder-oriented commercial bank.

2. The definition and the nature of savings banks and cooperative banks

The discussion of the nature of savings banks and cooperative banks focuses on two aspects: their business models and their institutional features. Both banking groups share the regional focus of their business models; nevertheless, they traditionally have very different institutional features that, for each banking group, proved quite successful over the last two hundred years. Importantly, the banks' business models and their institutional features are interdependent and complementary to each other.[3] As the last decade documented and as will be elaborated in this paper, changes in banks' institutional features immediately affect their business models and vice-versa.

It is almost impossible to define the savings banks of the 21st century in a general and meaningful way that is applicable to every institution that goes under that name today. They are a very heterogeneous group. Even across countries in Europe, they have few common features and the distinction between savings banks and other banks is becoming less and less clear.[4] There are now only two features that all savings banks in Europe have in common: (1) their focus on savings and savings mobilization and (2) their clear regional and even local focus.

Until about 25 years ago, these two features of the business model of most European savings banks were closely connected to five institutional features. The most preeminent feature was[5] (3) that of being "public" banks which were in a certain sense owned or sponsored and governed by some regional or local public body such as a city or a county or a region. This does not imply that these authorities had property rights that owners of a private bank have, but it implies that they had certain rights and also certain obligations with respect to "their" savings banks. As public banks, savings banks were (4) organized under a public law regime. The next feature was (5) their dual objective: They were expected to support the local economy and the local people, and at the same time to operate according to common business rules and thus to be financially sustainable enterprises.

Another common feature was (6) their adherence to the so-called regional principle, which restricts the operations of a savings bank to the area for which the public body is responsible. As banks that adhere to the regional principle and are firmly rooted in the local economy do not compete with each other, the different savings banks in a country or region had reasons to consider each other more as peers and colleagues than as competitors. This is why it is easy and attractive for them to cooperate, and it leads to the seventh traditional feature of savings banks in Europe: They were (7) part of dense and closely

[3] See Schmidt and Tyrell (2004) on the meaning and importance of the concept of complementarity in the context of financial institutions and financial systems.

[4] The list of those self-declared savings banks that are members of the World Savings Banks Institute, the international association of savings banks, provides a very good illustration of this heterogeneity. See also Manghetti (2011, p. 141) on the problem of defining savings banks in a way that would allow distinguishing savings banks from other banks today.

[5] Features (3) to (7) were applicable in the past or, as the case may be, they are also still applicable today.

cooperating networks of legally independent institutions that constitute a special banking group. [6] These networks offer the opportunity to have a common appearance vis-à-vis clients and the general public, share information and, most importantly, "outsource" certain functions in which economies of scale can be achieved to central institutions that are also part of the networks. Being part of such networks strengthens their competitive position within the respective national banking system.

This list of seven features constitutes the "prototype" of a savings bank. In the past, it was also valid as a description and allowed to distinguish savings banks from other banks. However, as we said before, today not all national savings bank systems exhibit all of these features any more.[7] In some countries savings banks are no longer public and municipal institutions operating under a public law regime and are no longer part of dense networks of affiliated institutions. Therefore one must restrict oneself today to defining savings banks simply as savings-oriented locally focused financial institutions that are called savings banks according to tradition and/or national laws and regulations.

Most cooperative banks are still today in many respects similar to how savings banks used to be. They are regional banks; they adhere to the regional principle; they are parts of dense networks that foster within-group cooperation, and they also have a dual objective. In their case, the mandate is to support the economic undertakings of their clients and to be cost-covering and profitable businesses. The specific feature of any cooperative bank – and thus also a criterion of demarcation from other banks – is their legal structure. Although they have some features of corporations, cooperatives are organized almost like clubs. Therefore the owners and providers of equity are not called shareholders but members. Three principles shape the institutional structure of financial and other cooperatives. The "principle of self-help" implies that they are self-governed private organizations. According to the "principle of identity", members are their main clients and conversely many of their clients are also members. Then there is the "democratic principle". It manifests itself in the rule that one member has only one vote in the annual general meetings, irrespective of how many shares he or she may hold.

Since cooperatives are structured like clubs, members cannot sell their shares if they want to exit. They can only hand them back to the cooperative and in return get back what they have once invested, plus their part of accumulated profits. This feature has both negative and positive implications. Owner-members' incentives to monitor the performance of the managers are weak due to the fact that they can hardly benefit from policies that would increase the value of their shares because they cannot sell their shares at a higher market price, and they cannot exert pressure on management due to the fact that they cannot accumulate a sufficient number of voting rights. As a consequence, the incentives of

[6] The German term for these dense networks is "Verbünde". Since such networks of banks do not exist in Anglo-Saxon countries, there is no term in English that would properly capture the meaning of "Verbünde".

[7] Even in the past not all national systems of savings banks exhibited all seven features in the same way and to the same extent. One exception is that of Great Britain, where already one hundred years ago the formerly decentralized savings banks have been superseded by a single national savings bank. This is why we do not consider the British case in the article.

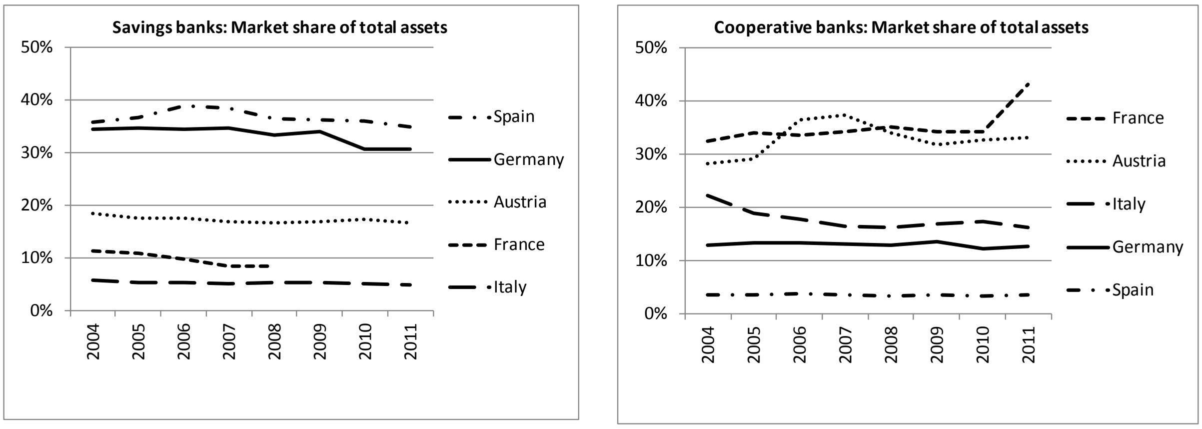
the managements to perform well and to increase the going-concern value of cooperative banks are also weak. Evidently, this constitutes a handicap for cooperative banks in their competition with other banks. At the same time the "democratic principle" and the limited incentives for management to make high profits imply that potentially powerful members cannot dominate a cooperative and make management exploit weaker members for instance by paying low interest rates on deposits. For the same reason, the incentives to incur high risks as a means of achieving high profits are weak in a financial cooperative.[8]

3. Savings banks and cooperative banks across Europe

3.1 Overview

The role of savings banks and cooperative banks varies significantly between European countries. This is related both to historical reasons and to developments over the last decades. Figure 1 presents the market share of total assets of savings banks and cooperative banks (including total assets of the respective central institutions) in terms of total banking assets in selected countries over the last years. As illustrated in the left panel, until today savings banks play an important role particular in Spain and Germany, but not so any more in several other countries.[9] The right panel highlights the strong role of cooperative banks in France and Austria, and only a very limited role in other countries such as Spain. Interestingly, in some countries, both banking groups play an important role, e.g., in Austria and in Germany. In other countries, one of the two banking groups clearly dominates the other one.

Figure 1: The role of savings banks and cooperative banks across Europe



Based on European Savings Banks Group (ESBG, 2013), European Association of Co-operative Banks (EACB, 2013) and European Central Bank (ECB, 2013). Note that the figures for savings banks and cooperative banks include the respective central institutions. For savings banks and cooperative banks, we calculate the market share for each country as the total assets of the respective ESBG and EACB member organizations, respectively, divided by the total assets of all financial institutions in that country as reported by the ECB. Missing values for savings banks for the years 2006, 2009 and 2010 were interpolated.

[8] Of course, a trade-off between the disadvantage and the advantage of the institutional set-up has to be found. Without going into details, one might add here that the monitoring function that is performed by certain central institutions of cooperative banking networks serves to limit the negative effects to a considerable extent. For details, see Ayadi et al. (2010), p 38.

[9] In France, savings banks were de facto transformed by law into cooperative banks in 1999, and they merged with the cooperative banking group Banques Populaires in 2009.

In the remainder of this section, we first discuss the development of savings banks and cooperative banks in Germany at somewhat greater length. We do this for two reasons: First, historically, the German savings banks and in particular the German cooperative banks served as a role model for similar banks in other European countries and around the world. Second, much more than those in almost any other country, the German savings and cooperative banks have maintained most of their traditional features over the last decades, and therefore arguably still correspond best to what one might call their prototypes. Subsequently, we briefly describe the developments and the current positions of savings and cooperative banks in selected other European countries, i.e., Austria, France, Italy and Spain.[10]

3.2 Germany

3.2.1 Historical development

The establishment of savings and cooperative banks in Germany goes back to the 19th century. The first savings banks were created about 200 years ago. They were foundations established by well-intentioned citizens with the mission of encouraging and enabling people of a low social standing to set aside some savings for a rainy day, a wedding or some other purpose. Then very soon municipal and public savings banks were created, and they soon became the dominant form. Over the years, the number of savings banks increased continuously, associations of savings banks were created and with the introduction of giro transactions in the early 20th century, regional clearing banks, which are now called *Landesbanken*, were established to support the savings banks operating in a larger region that would correspond to what are now different federal states in Germany. Together with the local savings banks, the *Landesbanken* and the associations formed a dense network of institutions. Later, additional institutions for special purposes, such as building societies, were founded and added to the network. However, the local banks remained the heart and the basis of the group.

The cooperative banks in Germany date back to the middle of the 19th century. Two groups of cooperative banks emerged at that time. The founder of the first group was Friedrich Wilhelm Raiffeisen. He laid the foundations for what was to become an extensive network of rural cooperative banks in Germany, which provided the model for cooperative banks in other European countries and finally in the entire world.[11] The second important group of cooperative banks was founded in an eastern part of Germany. They adopted the common name of people’s banks (*Volksbanken*). The founder of this group was Hermann Schulze-Delitzsch, a former public administrator and a politician.

Cooperative banking expanded as much as savings banks and soon covered all of Germany and also some neighboring countries, and like the savings banks they established dense networks of associa-

[10] For previous studies on savings banks and cooperative banks in Europe, also see Mottet et al. (2002), Fonteyne (2007), Ayadi et al. (2009) and Ayadi et al. (2010).
[11] Many of these cooperative banks are still today called “Raiffeisenbank” in order to honor the founder.

tions, clearing banks and affiliated specialized service providers. The German Banking Act of 1934 placed savings and cooperative banks under the same regulatory regime as all other banks. As a consequence, they became universal banks by law and in practice. For many decades, the two cooperative networks remained separate until they finally merged in 1972. As of then, cooperative banks may also conduct business with clients who are not members.

The German savings banks and cooperative banks have until today adhered to the regional principle described above, which implies that they are not competing with other banks in their respective banking group. This has enabled them to cooperate within their groups and to benefit greatly from being organized as parts of networks of closely connected, but legally independent institutions. Therefore, they are in a position to offer a full range of services to their customers without having to produce all of these services themselves, which would be too costly or, because of the small size of the local institutions, simply not feasible. Over time, and especially in the 30 to 40 years after World War II, both groups of regional banks underwent a process of professionalization and concentration – reducing the number of local institutions to less than one half over time – and of deepening the cooperation in their respective networks. During these years, the savings and cooperative banks were the most successful groups in the German banking system; they gained market share, were quite profitable and stable, and enjoyed a good reputation with clients and in the general public. In the early postwar years, the German banking market had been rather segmented, allowing savings and cooperative banks to become the main providers of retail banking services to German households and SMEs. The big private banks only started to serve the general public in the mid-1960s. This put some pressure on savings and cooperative banks, but they remained strong contenders in the banking market.

In 2001, the German government agreed with the EU Commission to phase out the former public guarantees for local savings banks and *Landesbanken* by the year 2005. While this had serious consequences for the *Landesbanken*, the local savings banks were hardly affected by this change since, first, they are largely financed by retail deposits, and second, for decades the group's internal risk control proved successful such that there was not a single case in which the public guarantees had been invoked. Further, in contrast to the business model of *Landesbanken*, that of the local savings banks has always been very safe, as their focus remained on their core business of operating locally.

3.2.2 The structure of banking networks

The savings bank group is organized in a three-level network. Savings banks operate at the local level. At the end of 2012, there existed 423 savings banks. Regional financial institutions such as *Landesbanken*[12], building societies and insurance companies typically operate at the state level. Other institutions, like DekaBank or Deutsche Leasing, operate at the national level. This three-level structure of financial institutions is mirrored in the structure of associations, with the German Savings

[12] After closures and mergers, there are by now seven economically and legally independent *Landesbanken* left.

Banks Association (DSGV) at the top representing the savings banks group to policy makers, public authorities and the general public. This national association also plays a certain role in shaping the general policy of the group. However, it is important to note that the savings banks group is neither by law and statute nor *de facto* a hierarchical system with central power residing at the top.

As in the case of the savings banks, the local cooperative banks – currently 1.104 – are the basis and the heart of the cooperative banking network. In addition, this network includes two central financial institutions and a certain number of specialized service providers operating nationwide[13]. The central financial institutions are DZ-Bank-AG and WGZ-Bank-AG. The larger one, DZ-Bank, is not only the central bank for most local cooperative banks but at the same time also one of the largest commercial banks in Germany. It operates on the national level and also to a certain extent internationally. WGZ-Bank is a regional central bank for the cooperative banks in the Rhineland and the only regional central or clearing bank that still exists today; the others have been merged into DZ-Bank over time. Similar to the case of the savings banks group, there are regional associations of cooperative banks and one national association. The latter plays a role that closely resembles that of the DSGV.

3.2.3 Market situation

Until today, the German banking system is a so-called "three-pillar system". The first pillar is formed by the private banks. It includes the "big banks" which have nationwide branch networks.[14] The savings bank group is the second pillar, and the cooperative banking group is the third pillar.[15]

Table 1 shows the numbers of institutions and branches of the three "pillars" for 2000 and 2012.

Table 1: Number of banks and branches by banking groups in 2000 and 2012

	Institutions				*Branches*			
	2000		*2012*		*2000*		*2012*	
	number	*(%)*	*number*	*(%)*	*number*	*(%)*	*number*	*(%)*
Private commercial banks	294	(10.7%)	390	(19.7%)	6,520	(15.1%)	9,610	(26.5%)
Big banks	4	(0.1%)	4	(0.2%)	2,873	(6.6%)	7,041	(19.4%)
Regional banks and others	200	(7.3%)	209	(10.6%)	3,567	(8.2%)	2,444	(6.7%)
Branches of foreign banks	90	(3.3%)	177	(9.0%)	80	(0.2%)	125	(0.3%)
Savings banks group	575	(21.0%)	432	(21.9%)	17,530	(40.5%)	13,094	(36.1%)
Savings banks	562	(20.5%)	423	(21.4%)	16,892	(39.0%)	12,643	(34.9%)
Landesbanken and DekaBank	13	(0.5%)	9	(0.5%)	638	(1.5%)	451	(1.2%)
Cooperative banks group	1,796	(65.5%)	1,106	(56.0%)	15,357	(35.5%)	11,789	(32.5%)
Cooperative banks	1,792	(65.4%)	1,104	(55.9%)	15,332	(35.4%)	11,778	(32.5%)
Central institutions	4	(0.1%)	2	(0.1%)	25	(0.1%)	11	(0.0%)
Other banks	75	(2.7%)	48	(2.4%)	3,887	(9.0%)	1,746	(4.8%)
All banks	2,740	(100.0%)	1,976	(100.0%)	43,294	(100.0%)	36,239	(100.0%)

Based on Deutsche Bundesbank (2013). Note that as of 2004, big banks include Postbank AG with its many branches.

[13] Among them are the Bausparkasse (Building Society) Schwäbisch-Hall and the asset management company Union Investment, both are among the largest institutions of their kind in Germany.

[14] „Big banks" (Grossbanken) is a term and a classification employed in the official statistics of the Bundesbank, Germany's central bank. It refers to those banks that have large branch networks. The group currently includes Commerzbank AG, Deutsche Bank AG, Deutsche Postbank AG and UniCredit Bank AG (formerly HypoVereinsbank AG).

[15] For a through description and analysis of the German banking sector see Hackethal (2004). A discussion of German savings banks can also be found in Ayadi et al. (2009, p. 113-138) and of German cooperative banks in Ayadi et al. (2010, p. 27-42). Articles on German cooperative banks are Kotz and Nagel (2002) and Kotz et al. (2007).

Table 2 contains information on the groups' market shares with respect to total assets, loans to non-banks and deposits and borrowing from non-banks for the years 2000 and 2012.

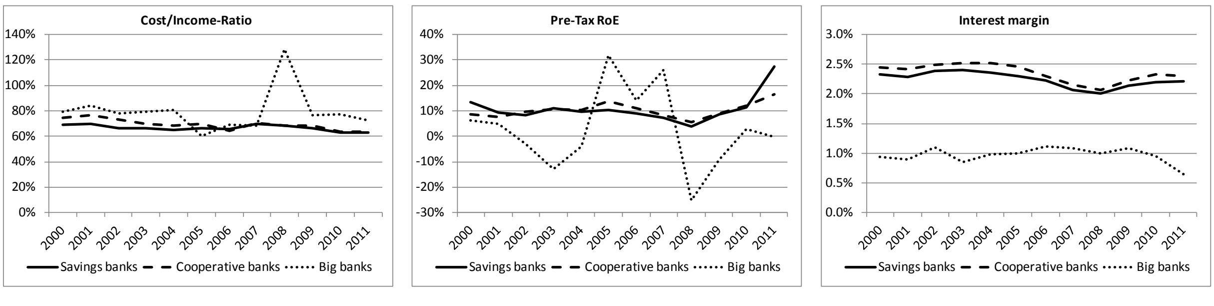
Table 2: Market share by banking groups in 2000 and 2012

	Total assets		Loans to non-banks		Deposits and borrowing from non-banks	
	2000	2012	2000	2012	2000	2012
Private commercial banks	28%	39%	26%	27%	26%	36%
Big banks	16%	25%	15%	13%	14%	17%
Regional banks and others	10%	10%	10%	13%	12%	16%
Branches of foreign banks	2%	4%	1%	1%	0%	3%
Savings banks group	35%	28%	35%	36%	39%	34%
Savings banks	16%	13%	19%	21%	26%	24%
Landesbanken and DekaBank	20%	15%	16%	15%	13%	11%
Cooperative banks group	12%	12%	12%	15%	18%	17%
Cooperative banks	9%	9%	11%	13%	17%	16%
Central institutions	4%	3%	2%	2%	1%	1%
Other banks	24%	20%	26%	22%	17%	12%
All banks (in billion Euros)	6,148	8,315	3,479	3,949	2,261	3,328

Based on Deutsche Bundesbank (2013).

Over the years the local savings and cooperative banks have been able to prosper and at times even outperform the commercial and purely shareholder oriented banks. The following Figure 2 provides performance indicators of German branch banking and allows for an assessment of the financial situation of those banks in the three-pillars that have extended branch networks and are therefore to some extent comparable. The left panel of Figure 2 shows that the cost-income ratio is lower for savings banks and cooperative banks than for the large commercial banks. As shown in the middle panel, return on equity is on average higher and clearly more stable for savings banks and cooperative banks. Finally, the right panel shows that the interest margins for all banks have been steadily declining, but throughout the years the interest margins are higher for savings banks and cooperative banks than for big banks.[16]

Figure 2: Performance indicators of German branch banking



Based on Deutsche Bundesbank, Monthly Reports, September 2001-2012.

Not only standard performance indicators show that the local banks performed about as well and at times even better than the private big banks, but also more elaborate ways of analyzing and comparing performance confirm this result for the years before the financial crisis began in 2007. For example, Altunbas et al. (2001) examine a sample of German banks between 1989 and 1996. They find that

[16] The performance indicators of the central financial institutions of the savings bank group and the cooperative bank group, which are not shown in Figure 2, are largely similar to those of the big banks.

public and mutual banks are not less efficient, but rather have slight cost and profit advantages over their private sector competitors. This may appear particularly surprising given that savings and cooperative banks pursue the dual objective of profit and benefit for their customers, an effect that cannot be included in standard performance measurements.[17]

Probably less surprising, but equally relevant, is the empirical evidence for Germany that savings banks and cooperative banks are on average less risky than privately-owned commercial banks (Beck et al., 2009). Note that some earlier cross-country studies find that publicly owned banks are more risky than privately owned banks (e.g. Iannotta et al., 2007),[18] or that a higher share of government ownership results in higher banking fragility (La Porta et al., 2002).[19] These studies, however, focus on large publicly owned banks and therefore do not provide any contradicting evidence as regards the stability of locally oriented savings banks.

Further, Behr et al. (2013) find that the lending of German savings banks is less cyclical compared to that of the private banks and that German small and medium-sized enterprises that increase their borrowing from savings banks are less credit constrained, based on a sample for the period 1995 to 2007. Hence, the high financial stability of German savings banks also benefits their clients.

3.2.4 German branch banks during the financial crisis

In contrast to the large banks which experienced large losses due to overly risky investments and off-balance sheet activities of a precarious nature in the years preceding the financial crisis, German local savings and cooperative banks weathered the storm largely unharmed. Almost all of them managed to remain stable and profitable during the crisis years.[20] This is foremost due to their traditional business model concentrating on the core-business of banking and corresponds to their mission and tradition. The local banks benefitted from their strong customer deposit-gathering ability and their established close relationships with their business clients. Moreover, their rather conservative business models prevented them from becoming involved in those lines of risky business that created great damage to most large private banks. Moreover, in contrast to other banks, the savings and cooperative banks have not curtailed lending in the crisis.

[17] Fonteyne (2007) correctly points out that merely comparing performance figures at the level of the institutions would be misleading since it leaves out benefits created at the level of the clients.

[18] For a sample of 181 large banks (with total assets of at least Euro 10 billion) from 15 European countries, Iannotta et. al. (2007) find that cooperative banks have better loan quality and lower asset risk than private banks, while private banks have better loan quality and lower insolvency risk than public sector banks. They do not explore risk proxies of small local banks.

[19] The findings by La Porta et al. (2002), which also suggest that private banks are better for economic growth than public banks, were very influential for banking reforms around the world during the last decade. However, more recent studies question that their findings can be generalized. For example, Körner and Schnabel (2011) find that a negative impact of public ownership on growth is only evident for countries with low financial development and low institutional quality.

[20] One cooperative bank, Apo Bank, also reported a loss in 2008. Interestingly, it is an atypical cooperative bank since it is not regionally focused and instead serves two professions, those of doctors and pharmacists, as its clientele.

Nevertheless, like almost every financial group, the savings banks group as a whole was also affected by the financial crisis. Four *Landesbanken* (HSH Nord, BayernLB, SachsenLB and WestLB,) suffered greatly, indirectly also causing large losses to local savings banks and other institutions in the banking group in their roles as co-owners, guarantors and business partners. This is one reason why some *Landesbanken* are currently undergoing major reforms (HSH Nordbank and BayernLB), were merged (SachsenLB with LBBW), were largely liquidated (WestLB), or are re-aligning their business models. Other Landesbanken such as Helaba did relatively well during the financial crisis, and thus strengthened their positions within the savings banks group.

Being even less involved in structured finance and capital markets products than the savings banks, the cooperative banks have survived the financial crisis better than any other banking group in Germany, even though their central financial institutions DZ-Bank also had some problems and needed help, which it got from other institutions belonging to the network. Very soon, these problems were overcome, and DZ-Bank returned to profitability.

In concluding, one can say that despite some problems with their central financial institutions, savings banks and cooperative banks have proved to be a stabilizing factor for the German financial system and economy. The financial crisis has strengthened the positions of the two groups of banks and thereby also stabilized the traditional three-pillar structure of the German banking system.

3.3 Austria

The Austrian savings bank group currently consists of *Erste Bank Österreich* ("Erste Bank"), which is the largest Austrian savings bank and the group's central financial institution, further 47 regional and local savings banks, the holding company *Erste Group Bank AG* ("Erste Group"), and several associated service institutions. As in many European countries, Austrian savings banks were founded in the 19th century. They were created with similar intentions and in much the same way as their peers in Germany: They were local initiatives, created in most cases by public authorities or by groups of citizens with a strong sense of social commitment.

Over the last decades the Austrian savings banks sector went through profound structural changes. Only in 1979 the Austrian Savings Banks Law allowed them to become truly universal banks. This reform also abolished the regional principle, which encouraged several savings banks to start operating at the national level. In 1986, a revision of the Savings Banks Law permitted splitting up a savings bank into two entities with different legal forms. The operating part of the bank was offered the option to become a "savings bank stock corporation", while the former savings banks continued to exists as the owners of their shares. The reform led to a complex structure of cross-ownerships with some savings banks holding shares in other savings banks. In 1997, Erste Bank acquired the former central institution of the savings banks, GiroCredit, and subsequently became publicly listed on the Vienna Stock Exchange. As the dominant savings bank in Austria with more than half of the total assets of all savings banks, Erste Bank seems to have to a certain extent pushed the other savings banks into a secondary role. As of 2008, Erste Group was created as a holding company for Erste Bank, as well as the bank's holdings in Eastern European banks and in other Austrian savings banks.

There are two groups of cooperative banks in Austria, the larger group of *Raiffeisen* banks operating mainly in rural areas and the smaller *Österreichische Volksbanken-Gruppe* (ÖVB group) with an urban business focus. In contrast to the German case, these two groups still exist side by side. The central institutions of both groups, *Raiffeisen Zentralbank Österreich AG* and *Österreichische Volksbanken AG*, respectively, are at the same time large commercial banks in their own right. As in the case of Erste Bank, the relative importance of the central institutions for the cooperative banking groups is quite large.

For many years, savings banks and cooperative banks have played a major role in the Austrian banking market. Their market share in terms of total assets, loans and deposits is around 50%.

The Austrian banking market in the 1970 and 1980s was characterized by an over-expansion of bank branches and a tight squeeze on the banks' profitability. In this situation all banks felt the pressure to look for new markets. In view of the history and geographical position of Austria it is not surprising that they all seized the opportunity to expand into the neighboring countries of central and southeast Europe after 1989. As regards the Austrian savings banks and cooperative banks, this move proved to be very successful for many years, and it strengthened the position of their respective central institutions even more, since the Eastern European business was organized by them and the profits made by them accrued at their level. This development has changed the former characteristics of savings and cooperative banks of being decentralized and non-hierarchical networks of independent institutions, which has caused some consternation among the truly regional and even local savings and cooperative banks.

Because of their rather conventional business model, the smaller local savings banks and cooperative banks in Austria were not directly affected by the financial crisis. They had relatively few investments in high-risk assets, and their lending operations have been quite conservative, which corresponds to their mission and tradition. The situation for the central institutions of the savings banks and cooperative banks is different and clearly worse. Business operations in Eastern Europe are much more risky than domestic banking, in particular for banks that are very active in consumer lending, as it is the case for several Austrian banks in the neighboring countries. The impact of the crisis on the Austrian banks in Eastern Europe was very strong, and as a consequence the central institutions have incurred losses, which adversely affected the respective banking groups, especially that of the *Volksbanken*.

3.4 France

Savings banks have a long tradition in France: The first savings bank was founded in Paris in 1818 as a private initiative, and they were recognized as private institutions of public utility since the late 19th

century. Until the 1950s, their mandate was restricted to promote, collect and manage popular savings. In return, the savings banks were granted some tax privileges, e.g., as regards the popular savings account *livret A*. Since the 1950s, several reforms allowed the savings banks to widen the scope of their services, and to become more similar to locally oriented universal banks. With the aim of making the savings banks more competitive, a merger wave led to a sharp decline in their number, from a peak of around 500 to only 31 in the early 1990s. However, the pressure on savings banks remained high during the 1990s because of their low profitability and of constant criticism from private competitors concerning their status as public institutions. In 1999, a law transformed savings banks into the legal form of cooperative banks, and in 2009 the group of cooperative savings banks merged with the cooperative group *Banque Populaires*. Today, French savings banks still exist as a brand under the group *Banque Populaire Caisse d'Epargne* (BPCE), but they are no longer comparable to publicly owned savings banks in the traditional sense.[21]

In contrast to the former public savings banks, the cooperative banks continue to be an important element of the French banking system. Today, the cooperative sector comprises three distinct groups: *Banques Populaires Caisses d'Épargne* (BPCE), *Crédit Mutuel* (CM) and *Crédit Agricole* (CA). Together they hold market shares of nearly half of total banking assets, loans to households and businesses and customer deposits. Each one of them consists of a network of local banks and a powerful central institution, which are all among the largest banks in France. While the local banks are private cooperatives in the traditional sense of the term, the central institutions are corporations whose shares are, in different proportions, held by the local cooperatives and outside institutional and retail investors. All of these groups have existed since the turn of the 19th to the 20th century, and in contrast to private commercial banks, they traditionally mainly served smaller communities and less developed and thinly populated parts of the country. Until the mid-1980s, all cooperative banking groups have to a certain extent been controlled by the French government.

There are several noteworthy features of the French cooperative banks. One is their sheer size and their remarkable market share. Another one is how they have gained their current status. This came about in the course of the reform of French banking in the 1980s. When the former tightly regulated, government controlled and fragmented banking system was liberalized, several large private and public banks found it difficult to adjust to the new more competitive environment and involved themselves in some very risky lines of business. The cooperative banks, in contrast, were more cautious, stuck to their local roots and came out of this process of political change as stronger institutions. As such, they were then in a position – and legally allowed – to take over formerly private and public banks. The first one of these take-overs was that of the former private bank CIC by Crédit Mutuel in 1998. The most spectacular one was that of the large commercial bank Crédit Lyonnais by Crédit Agricole in 2003, which made Crédit Agricole one of the largest banks in France. Several other acqui-

[21] For a discussion of the French savings banks and their reform, see Moreau and Boukhorssa (2002) and Polster (2005).

sitions and take-overs of banks that had formerly not been cooperative banks followed. The last major episode of that kind was the merger in 2009 of Banque Populaire with the former savings banks.

Although they are by now no longer restricted by law to limit their activities to a narrowly described area, the local cooperative banks essentially adhere to the regional principle, which makes it easier for them to cooperate in their respective networks.

In the years after the initial liberalization, the cooperative banking groups did not only grow internally and through acquisitions. They were also more profitable and less risky than the large private banks. Throughout the years, the French cooperative banks retained their role of being important providers of loans to all segments of the population and to businesses, especially to SMEs.

The French local cooperative banks have survived the crisis largely unscathed. However, their central institutions suffered considerably and, like the large private banks, were forced to accept government support in the crisis. By now, state funding has been paid back in all cases.

As a general conclusion, one can say that by adjusting their institutional design to the requirements of the new banking regime in France and becoming a hybrid between local cooperatives and stock market listed corporations, the French cooperative banking groups have succeeded in retaining and even expanding their strong position in the French banking market.

3.5 Italy

In Italy, municipal or public savings banks and cooperative banks had existed since the late 19^{th} century, in many cases designed according to German models. They were small local banks cooperating in networks and serving the local population more or less well. However, they have not gained as much importance as their German, Austrian and French peers. During the long period in which Italian banking was fragmented, repressed and overregulated, they survived, though with considerable problems of efficiency and profitability.

The privatization of Italian savings banks started in the late 1980s. The Amato banking reform of 1990 further pushed the privatization of the numerous Italian state-owned banks. The savings banks were first transformed into joint-stock companies and then privatized by transferring the ownership of the majority of the shares to private charitable foundations. Additional legislative changes in the 1990s abolished of geographical restrictions, limited the fraction of the shares that any one foundation could hold in one savings bank and finally led to the merger with banks of various types and the creation of large nationally as well as internationally operating banks such as UniCredit and Intesa-San Paolo. Thus one can say that with a few exceptions, savings banks have disappeared in Italy. Those large institutions which resulted from this transformation of the formerly public savings banks may be quite successful banks, but they no longer have any features of local savings banks.

Of course, some savings banks such as that of the province of Lombardy had been large and successful before they were integrated into the big banking groups. But the majority was not, and they would in all likelihood not have been able to survive in the new liberalized and more competitive environment of the 1990s and the following decade. Nevertheless, it is interesting to ask whether the far-reaching transformation - and de facto abolishment - of the former local savings banks was beneficial for their clients and the Italian economy, which after all relies heavily on medium-sized, small and very small firms. Several studies of this issue have come to the conclusion that it has led to a reduction of credit availability for Italian SMEs,[22] and Carletti at al. (2005) draw the lesson from the Italian experience that privatizing and transforming savings banks in the way in which this has been done in Italy would certainly not be recommendable for other countries such as Germany.

The Italian cooperative banking sector consists of two cooperative networks: *Banche di Credito Cooperativo* (BBC) and *Banche Popolari* (BP). While the BBCs are smaller as individual institutions and as a group and more active in rural areas, the BPs are typically larger and mainly conduct business in towns and cities. These two cooperative banking groups also differ in their lending business. While for the BBCs small business lending amounts to roughly 70 percent of their total loans, this share is much lower for BPs, accounting for one third up to one half.

The legislative changes in the 1990s encouraged the BBCs to keep on their original model as far as their organization as cooperatives and their local business focus are concerned. Furthermore, through certain tax rules they were encouraged to retain their profits and to build up reserves. In contrast to the BBCs, the BPs have been transformed in a way that makes them almost “normal” banks. The relevant laws largely removed the former restrictions and allowed the BPs to drift away from their former cooperative and local roots. They are now permitted to issue shares which are transferrable with almost no restrictions and to expanding their business geographically and operationally. A wave of mergers has lead to more concentration and to the development of large cooperative banks belonging to the BP banking network.

3.6 Spain

Not long ago, the Spanish savings banks (*cajas*) appeared to be very successful. They had an impressive and growing market share of around 50 % and by and large were so profitable and efficient that one would not be able to see any difference in their performance to the private banks including the giant Spanish banks Santander and BBVA.[23] In a publication by the European Savings Banks Institute, Manghetti (2011) even called them a model of successful savings banks. However, this has drastically changed in recent years. The ups and downs of the Spanish savings banks in the past two decades can

[22] See, e.g., Berger and Udell (1995) and Patti and Gobbi (2001).
[23] For details, see Aydadi et al. (2009) covering the time before the financial crisis and the government debt crisis.

be traced back to the reform that started after Spain's accession to the EU in 1986 and occurred under the pressure of the EU which was strongly opposed to publicly owned banks.

Until the 1970s, the Spanish savings banks had been public institutions. As such they had always been exposed to far-reaching political interventions and their activities were restricted to narrowly defined areas and in terms of which operations they could undertake. There were many local savings banks, and they were small and not particularly efficient institutions. With the reforms and the economic liberalization that began in the 1970s, they were reshaped to become modern financial institutions. They were privatized, the regional principle was abolished and they were granted the freedom to provide a broad range of financial services in all parts of the country. This transformed them into universal banks and important competitors to other institutions in the banking sector. However, for many of them this new business model proved to be unsustainable.

The financial crisis has had a significant impact on the Spanish economy. It brought about an abrupt end of the real estate boom and in its wake severe losses for all Spanish banks. But the savings banks had been most exposed to commercial real estate and were therefore most affected by the downturn. Losses mounted and many savings banks were *de facto* bankrupt. In spite of their recently acquired status of being private institutions, they were rescued with public funds and/or were forced to merge with other banks. Before the crisis there had been 45 independent institutions, and within only four years, this number was reduced to 11. Nonperforming loans, which had been as low as 1 percent in 2007, soared to 10 percent on average and much more in certain savings banks including Bankia, a new institution that had been formed during the crisis by merging several ailing savings banks in the Madrid metropolitan area. [24]

There are essentially two reasons for the crisis of the Spanish savings bank sector. One is the half-hearted privatization, which endowed the savings banks with the status of a private corporation that were allowed and perhaps even expected to operate on a nationwide scale, but at the same time left local politicians in very powerful positions. When ownership and governance are not adjusted to each other, failure can easily be expected. [25]

The second, and in fact complementary, reason for the serious problems that only surfaced during the past five years is the demise of the regional principle in 1988. This allowed the savings banks to expand their branch network to other regions, and many of them made use of this opportunity. As a consequence, savings banks opened so many branches outside of their traditional catchment areas that the branch density in Spain became two times as high as the euro-area average. As one could have expected, this growth intensified competition in the Spanish banking sector, put pressure on profitability and, as a reaction, induced several savings banks to engage in high-margin, high-risk lines of

[24] For a detailed discussion on the reform of Spanish savings banks and the financial crisis, see IMF (2012b).

[25] A critical assessment of the governance of Spanish savings banks after the reforms – and thus of the half-hearted privatization – can be found in Mai (2004).

business, most notably commercial real estate lending.[26] When the real estate bubble burst in the years 2009 and 2010, the savings banks, and in fact also the whole country, were in deep trouble.

There are also cooperative or mutual banks in Spain. They are small institutions, in most cases firmly rooted in their respective local economy. However, they have always been of much less importance than the savings banks. Their market share has never surpassed 10 percent. Also their growth during the boom years of the 1990s and the early years of the new century was less pronounced. With only minor modifications, they also maintained their former institutional features and their strong local roots. This enabled them to achieve equally stable earnings and profits for many years. Of course, the real estate crisis and the ensuing general economic crisis in Spain also have had an adverse impact on the cooperative banks. But because of their conservative business model, at least so far, they have been less exposed to the crisis and retained relatively high repayment rates in their lending operations.

3.7 Summary and assessment

Until about 25 years ago, almost all European countries had a so-called "three pillar" banking system comprising private banks, (public) savings banks and (mutual) cooperative banks. Since that time, several European countries have implemented far-reaching changes in their banking systems, which have more than anything else affected the two "pillars" of the savings and cooperative banks. The most important changes in Germany, Austria, France, Italy and Spain have been described above. The following few brief remarks on other European countries show that in some countries the changes have gone even further.

In Belgium savings and cooperative banks have essentially disappeared. In Great Britain the former public savings bank (TSB) was sold to Lloyds Banking Group, and several cooperative banks, the so-called building societies, were converted into corporations and some of them were sold to large private commercial banks. In the Netherlands savings banks have disappeared and the formerly independent cooperative banks have been amalgamated into one big national bank (Rabobank). In Sweden, the former local savings banks have been converted into joint stock corporations in the 1990s, and most of them were consolidated into a single national savings bank (Swedbank).[27]

Only Germany stands out as the special case in which there was no substantial change during the last decades.[28] As far as their legal and institutional structures are concerned, the German savings and cooperative banks are today almost exactly as they had been 50 and even 80 years ago.

There have been several factors that drove the changes in Europe. Certainly, the political climate of the time and EU-wide harmonization were important. However, there was also the presumption that in

[26] See IMF (2012a) for the expansion of branch networks as a cause of the Spanish banking crisis.
[27] Details can be found in the two volumes by Ayadi et al. (2009, 2010).
[28] An exemption is the abolishment of public guarantees for German Landesbanken and local savings banks since 2005.

their former set-up the regional banks were not competitive. To a certain extent, this may have been true, and it may have been due to the fact that in most countries savings and cooperative banks had long been subject to different and more restrictive regulation than "normal" banks and/or to the small size of most local banks and/or to their "unconventional" institutional and governance features.

As one of the motives for initiating far reaching reforms was the belief that the efficiency of local savings and cooperative banks is lower than that of other banks with comparably large branch networks, it is instructive to take a closer look at this aspect. As already discussed in this paper, evidence from the German banking market does not support the belief that local savings banks and cooperative banks are less efficient. Further, in two cross country studies of regional banks in Europe for the period 2000 to 2008 and 1996 to 2006, Ayadi et al. (2009 and 2010) have investigated whether banking groups with different institutional features also differ in terms of efficiency. Like several earlier studies[29], these two studies did not find any systematic differences. The frequently used indicators of efficiency – return on assets, return on equity and cost-income ratio – are essentially the same for savings banks, cooperative banks and large private branch banks in almost all countries considered in the studies. More sophisticated econometric methods also failed to reveal any systematic differences. Of course, this could only be shown for countries in which savings and cooperative banks still existed during the years covered in the analyses, which were essentially the pre-crisis years.

But there is one important difference: the savings banks and cooperative banks in many countries displayed systematically lower variability of the efficiency indicators over time than the large private banks, suggesting that they were systematically less risky during the time periods covered in the studies.

As is well known, the former similarity concerning efficiency across countries was not maintained during the financial crisis of 2007 to 2009 and the debt crisis that erupted in 2010. Most savings and cooperative banks also fared relatively well in the crisis and better than most of their competitors from the ranks of large private banks. This is due to the fact that, by virtue of their institutional design, they have limited incentives to take on greater risks, while their strong local roots and their embeddedness in close networks puts limits on their possibilities to do so.

However, there are exceptions. As discussed above, the most important one is that of the Spanish savings banks. They were very seriously affected by the crises. For researchers who regard incentive systems and institutional design as important, their structural weakness does not really come as a surprise. Most probably their current problems are related to the fact that the *cajas* were transformed in an unbalanced way a few years before the crisis hit, and the regional principle was abolished by law and statute as well as in practice. As a consequence, the *cajas* started to compete vigorously among

[29] See also Birchall and Ketilson (2009) and most recently Birchall (2013).

themselves, putting pressure on their profitability. This could also explain why there is now hardly any cooperation between them, nor is there a network that could provide support and impose discipline on the individual *cajas*.

4. Lessons and perspectives

The preceding comparison of the developments of savings banks and cooperative banks in several European countries holds a number of interesting lessons that also serve as a basis for some speculations concerning the future of these types of banks.

The first lesson refers to the degree to which the national systems of savings and cooperative banks have become different in recent years. Savings banks in some countries, if they still exist at all, do not share the traditional institutional features that savings banks used to have 25 years ago. It is indeed stunning, and, as discussed in the following, some of these changes are unconvincing from an economic and political perspective, and tend to undermine the genuine strengths of savings banks.

The second lesson concerns the question whether decentralized networks of local banks are at all viable over the longer term. It is of course impossible to make any general statement concerning how the locally rooted banks would have fared if there had not been any reforms and how those that no longer exist would have fared if they still existed. However, for those that survived one can say that, compared to private commercial banks, they performed well and thereby showed their ability to survive in an increasingly tough market environment in the pre-crisis years and in most cases also during the crisis. As it seems, they are on average as efficient and clearly less risk-prone than comparable private banks. Their unusual institutional designs seem to lend them substantial competitive strength.

The third lesson is based on the experience during the crisis years. Here substantial differences between national regional bank systems showed up.[30] Referring again to the case of the Spanish savings banks,[31] we argue that the specific design features of national systems of local banks are of paramount importance. Creating an institutional environment that does not support within-group cooperation of public and member-owned decentralized local banks or even militates against cooperation, thereby weakening their governance, is a recipe for failure. It is highly unlikely that relatively small local or at most regional banks can survive as stand-alone institutions under competitive pressure. But this assessment can also be turned around leading to the proposition that maintaining an appropriate business model and institutional structure may be the recipe for (relative) success and survival. The appropriate business model is that of being firmly rooted in the local economy and

[30] Such differences can also be observed between different systems within one country, see the two Austrian cooperative banking systems.

[31] As mentioned above, the German regional banks *(Landesbanken)* are another example. Already before the first crisis, they had lost or simply abandoned their old business model.

aspiring to strike a balance between the need to make a profit and the aim of serving members and clients; and the appropriate institutional structure is that of being embedded in a decentralized and dense network of affiliated financial and non-financial institutions.

In concluding, we want to turn to a more political aspect of the possible future of regional banks. Among other things, the financial crisis has led to a change in the prevailing political assessment of the various types of banks in Europe. Before the crisis, banks that did not conform to the "model" of how a good modern bank should be structured and operated were considered to be old-fashioned and outdated. This assessment referred primarily to savings banks in so far as they were public banks. But at least indirectly cooperative banks were also under suspicion since they are also not purely profit oriented institutions and not large centrally coordinated and stock exchange listed corporations.[32] After the crisis, this attitude has changed. Banks with public ownership and member or client based financial institutions have regained some recognition, because the vast majority of them had fared better than their larger purely private competitors and also because they have held up their supply of loans to the economy at a time when big banks cut back lending. This political reassessment bodes well for their future.

One additional consideration points in the same direction. The financial crisis has generated the insight that in the area of banking there can be too much profit orientation, too much profit pressure emanating from the capital market on listed banks and too much financial sophistication. Working together these factors can lead to banks accepting and even generating too much risk for themselves as institutions and for society. Local and regional banks are less risky and this contributes to the stability of entire financial systems. Their contribution to financial system stability might suggest that from an overall perspective they might simply be the better banks. However, such a claim would go much too far. But the converse is also not true. The "modern" view that all financial systems should resemble as much as possible the model of a financial system in which capital markets are the most important force and in which banks are large, private, purely shareholder-oriented and exchange-listed corporations has been severely discredited by the experiences from the recent financial crisis. We simply do not know which type of bank and which structure of a financial system are better under different circumstances.

This agnostic position leads to the argument of diversity. In the life sciences, the value of diversity has been widely recognized in recent years, and there is a crucial underling argument why biodiversity is so important: Even the best experts do not know, and in fact cannot know, what the future challenges to human life and health and to the environment may be. There is the possibility that some specific species might in the future turn out to be extremely important, for example, for curing a disease that

[32] For details on this political debate see Schmidt (2009).

may not even exist today. This is why protecting this species – and endangered species in general – is important: Once they are extinct they cannot be revitalized even if they would be urgently needed.

Much the same applies to the types of banks and banking groups that are the topic of this article. As we simply do not know which type of bank is best if regarded in isolation and which mix of different types of banks within a financial system is best for the economy and for society at large, we regard it as very important to "preserve" these types of banks and prevent them from being sidelined or even abolished. They are like an endangered species. If they cannot continue to exist and thrive today as what they are and cannot adapt to changing circumstances, then the valuable knowledge and the social capital that they use and transfer to future generations might be lost once and for all. After all, these banks – and even more so the networks of such banks - are rather subtle organizations that have so far managed quite well to cope with the delicate tension between the business imperative of being successful enterprises and their social mandate to support their clients and members. If they disappeared it would most likely be impossible to bring them back to life if later generations should come to the conclusion that it would be good to have strong and prospering banks that serve public or client interests more than, or at least as much as, the interests of shareholders. If policy makers accept this argument and act accordingly, they would not only ensure the good prospects of savings banks and cooperative banks, but also provide for the future development of the banking systems in Europe.

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