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Position Paper

Cooperative Banks to the Rescue

Food for thought on funding the Mittelstand in the EU

About a decade after Lehman Brothers went bankrupt, many problems of the European financial sector remain unresolved. One measure that could help would be the revival of regional cooperative banking systems in European countries – taking as a model the regional cooperative banks in Germany, Volksbanken and Raiffeisenbanken.

1. Since the costly bailouts of large international commercial banks, the market power of the largest financial institutions has increased further. For example, the five largest banking groups in the Euro area now enjoy a market share of 48 percent, four percentage points more than in the crisis year 2008 (Source: : ECB Report on financial structures, October 2016).

2. Since private international major banks issue relatively few loans to companies, small and medium-sized enterprises (SMEs) in many EU countries do not have sufficient access to finance. 24 percent of SMEs in Greece, and approximately 12 percent in Ireland, Italy, Portugal and the Netherlands see access to funding as their "most pressing problem" (Source: Survey on the access to finance of enterprises of the ECB, September 2016). In Germany this proportion is only 6 percent. Here SMEs have the benefit of the presence and strength of regional cooperative and savings banks. This finding is backed up by German statistics: According to data from the Bundesbank, corporate loans by the four biggest German banks constitute on average only about 8 percent of their balance sheet total. The figure for the Volksbanken and Raiffeisenbanken is about 30 percent.

3. The proposal of the EU commission to improve funding for SMEs mainly by strengthening the European capital market is impracticable. Capital market instruments benefit mainly large corporations. According to the DZ Bank, direct financing on the capital markets is only a realistic proposition for about 0.3 percent of all SMEs. Securitisation of loans to SMEs, which is an indirect form of capital market finance, is a risk-prone alternative – especially when there are hardly any regional banks locally. For responsible lending, sound knowledge of the small and mid-sized borrowers and their markets is needed.

4. A purposeful model for the financing of SMEs in the EU is presented by the German Volksbanken and Raiffeisenbanken. These "small enough to fail" banks have shown themselves historically to be reliable sources of funding for companies, in strong economic times and weak. This is ensured by, among others, the members of the cooperative banks, who themselves are often regional entrepreneurs. The fact that the cooperative banks are the only German banking group to have managed without state aid is also due to their tried-and-tested control mechanisms, such as the mandatory audits by the cooperative auditing associations as well as their protection scheme, which, since its creation in the 1930s, has always ensured that all affiliated banks have been able to meet their financial obligations.

5. In other parts of the EU, too, there were in the past small banks – often in the legal form of a cooperative – whose business model was clearly oriented on finance for the regional SMEs. In recent decades, these banking systems have developed away from the original model – to the harm of regional small and mid-sized industry. Rebuilding cooperative regional banks in such countries would mean a return to historic roots. The German cooperative banking sector can serve as a model for a successful modernisation that strengthens the Volksbanken and Raiffeisenbanken as regionally active and economically independent financial institutions: by the tried-and-tested division of labour, for example, in IT, asset management, building savings, insurance and consumer credit business. Such services are provided by cooperative service and technology companies, the central institution and special institutions. This also includes risk sharing and liquidity balancing which are provided by the cooperative central institution DZ BANK.

6. In order to prevent any weakening of finance for SMEs in Europe, the EU must look at which regulatory stipulations impose an unnecessary burden on small, sound and low-risk regional banks. The banking regulations must be tailored to both the size and the business model of each bank. Small, locally or regionally oriented banks are very different from the major banks listed on the stock exchanges. Therefore, the idea of a "Small Banking Box", which is debated on the EU level, is along the right lines.